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TRANSCRIPT OF RECORD.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1923.

No. 447.

THE UNITED STATES, APPELLANT,

vs.

THE SUPPLEE-BIDDLE HARDWARE COMPANY.

APPEAL FROM THE COURT OF CLAIMS.

FILED JULY 21, 1923.

(29757)

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1923.

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THE UNITED STATES, APPELLANT,

vs.

THE SUPPLEE-BIDDLE HARDWARE COMPANY.

APPEAL FROM THE COURT OF CLAIMS.

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1 In the Court of Claims of the United States.

The Supplee-Biddle Hardware Co., Plaintiff,
vs.
The United States, defendant.
No. B-198.

I. *Petition.*

Filed September 23, 1922.

To the honorable the Chief Justice and Judges of the Court of Claims:

Plaintiff respectfully represents:

1. The plaintiff is a corporation organized and existing under the laws of the State of Pennsylvania, and has its principal place of business at the city of Philadelphia, in said State, and is engaged in the business of selling hardware and allied merchandise.

2 2. On February 14, 1917, Robert Biddle, 2nd, was made president of the plaintiff corporation. Said Robert Biddle, 2nd, had come into the employ of plaintiff early in life and had acquired vast knowledge of the business conducted by plaintiff and had been promoted from one position to another until he was called to the presidency by the board of directors. In addition to his intimate knowledge of the business, said Robert Biddle, 2nd, was possessed of great executive capacity, and because of his knowledge of the business and of his ability to manage the affairs and personnel of the corporation his services were of immense value to the plaintiff and could not easily be replaced.

3. Plaintiff, realizing the value of the services of its said president, Robert Biddle, 2nd, caused two policies of life insurance to be taken out on his life, in order, so far as possible, to save the company harmless from great and irreparable loss in the event of his death. Accordingly, for the protection of the company, as aforesaid, on the 12th day of April, 1917, the said Robert Biddle, 2nd, took out a policy of insurance on his life in the Provident Life and Trust Company in the principal sum of $50,000, and on the 13th day of April, 1917, he took out an additional policy of insurance on his life in the Travellers' Insurance Company in the principal sum of $50,000. Both of said policies were for a term of five years, all of the premiums being paid for the risk and by the terms of said policies the plaintiff was not to recover any of the premiums or any other principal sum except by reason of the death of said Robert Biddle,
3 2nd, and in the event of his death the amount due under both the said policies was payable to the Supplee-Biddle Hardware Company. The premiums on said policies were paid by the plaintiff.

4. During the year 1918 the said Robert Biddle, 2nd, contracted influenza and died on the 12th day of October, 1918. He was then of the age of thirty-eight years, in the prime of his business life, and of inestimable value to the company. After his death, and

during the taxable year 1918 the insurance companies above mentioned paid to plaintiff on said policies, in all, the sum of $100,000, which, after deducting the premiums paid, made the net proceeds of said policies the sum of $97,947.28.

5. The plaintiff regarded this payment of $100,000 as an indemnity or return of capital, and not as income within sense of the revenue act of 1918 and the 16th Amendment to the Constitution of the United States, and accordingly made a return to the Commissioner of Internal Revenue for the year 1918, reporting a net income of $187,762.58, which did not include said sum of $97,947.28, being the proceeds of said life insurance policies as aforesaid. Plaintiff did attach to its return, however, for the information of the Commissioner of Internal Revenue, a statement showing that it had received, in addition to said net income, the sum of $97,947.28 as the proceeds of the life insurance policies on the life of Robert Biddle, 2nd, above referred to.

6. Over the protest of plaintiff, and contrary to the provisions of the revenue act of 1918 and the 16th Amendment to the
4 Constitution of the United States, the Commissioner of Internal Revenue added the proceeds of said insurance, to wit, $97,947.28, after allowing a deduction of $2,052.72 for the premiums paid from the $100,000 received by plaintiff, to the net income as reported and increased the net income by other additions, not here material, to the sum of $296,221.44. Upon the submission of its original return, plaintiff had paid a tax of $57,887.72, but because of the additions to net income made by the Commissioner of Internal Revenue an additional tax was assessed in the sum of $93,991.26, which sum plaintiff was required to pay by the Collector of Internal Revenue and did pay under protest, together with a penalty of $4,468.50 for alleged negligence in not reporting the proceeds of said insurance policies.

7. Owing to the action of the Commissioner of Internal Revenue in requiring the proceeds of said insurance policies to be reported as net income, together with the infliction of penalty for failure to report same as net income, plaintiff was compelled to pay a tax of $84,737.95, in addition to what it would have had to pay had the proceeds of said insurance policies not been taxed as income. Plaintiff says that the proceeds of said insurance policies was not income within the meaning of the revenue act of 1918, nor the 16th Amendment to the Constitution of the United States, but was in fact a return of capital and was not taxable as income. Plaintiff says that said tax of $84,737.95 on the $97,947.28 received as the proceeds of said insurance policies was practically a confiscation of said
5 proceeds and was erroneously and illegally exacted, contrary to the provisions of the Constitution of the United States and the revenue act of 1918.

8. On the 29th day of March, 1921, plaintiff filed a claim for refund with the Commissioner of Internal Revenue, asking for the refund of said $84,737.95, which claim was by said Commissioner rejected on the 14th day of September, 1921.

9. On the 22nd day of July, 1921, plaintiff requested a reassessment of its taxes under section 328a of the revenue act of 1918, and the Commissioner of Internal Revenue, after making a comparison between the net income of the plaintiff and of companies doing a like kind of business, made a reassessment of plaintiff's taxes and returned to plaintiff on July 14, 1922, the sum of $29,584.06, together with interest, and plaintiff, therefore, deducts said sum of $29,584.06 from the said sum of $84,737.95 and asks judgment for the difference, or $55,153.89.

10. No other action has been had on said claim in Congress or by any of the departments; no person other than plaintiff is the owner thereof or interested therein; no assignment or transfer of this claim, or any part thereof or interest therein, has been made; plaintiff is justly entitled to the amount herein claimed from the United States, after allowing all just credits and offsets; the plaintiff has at all times borne true faith and allegiance to the Government of the United States and has not in any way voluntarily aided, abetted or given encouragement to rebellion against the said Govern-
6 ment. The plaintiff is a citizen of the United States.

Wherefore, plaintiff asks judgment against the United States in the sum of fifty-five thousand one hundred and fifty-three dollars and eighty-nine cents ($55,153.89).

THE SUPPLEE-BIDDLE HARDWARE CO.,
By WILLIAM B. MUNROE,
President.

A. MITCHELL PALMER,
Attorney for Plaintiff.
FREDERICK L. CLARK,
FRANK DAVIS, JR.,
WM. D. HARRIS,
Of Counsel.

7 Jurat showing the foregoing was duly sworn to by Wm. B. Munroe. Omitted in printing.

8 II. *General traverse.*

Entered Nov. 23, 1922.

No demurrer, plea, answer, counterclaim, set-off, claim of damages, demand, or defense in the premises having been entered on the part of the defendant, a general traverse is entered as provided by Rule 34.

III. *Argument and submission of case.*

On April 24, 1923, this case was argued and submitted by Messrs. A. Mitchell Palmer and Frederic L. Clark, for the plaintiff, and by Messrs. Fred K. Dyar and R. B. Burchard, for the defendant.

IV. *History of proceedings.*

On May 7, 1923, the court filed findings of fact and conclusion of law, with an opinion by Hay, J., and entered judgment in favor of plaintiff in the sum of $55,153.89.

On May 21, 1923, the plaintiff filed a motion to amend the findings of fact and judgment.

9 V. *Order of court amending findings, etc.*

Entered May 28, 1923.

It is ordered by the court that the plaintiff's motion to amend findings and judgment be and the same is allowed.

The former findings of fact and conclusion of law are vacated, set aside, and withdrawn, and amended findings of fact with conclusion of law entering judgment in favor of the plaintiff in sum of $62,866.23 are now filed nunc pro tunc as of May 7, 1923—the opinion to stand.

By the Court.

10 VI. *Findings of fact, as amended, filed May 28, 1923, nunc pro tunc as of May 7, 1923, and opinion of the Court by Hay, J.*

This case having been heard by the Court of Claims, the court, upon the evidence, makes the following

Amended findings of fact.

I.

The plaintiff is a corporation organized and existing under the laws of the State of Pennsylvania and has its principal place of business at the city of Philadelphia, in said State, and is engaged in the business of selling hardware and allied merchandise.

Robert Biddle, 2d, when about 18 years of age, entered the employ of the Biddle Hardware Company, a partnership, about the year 1899. About January 1, 1914, the Biddle Hardware Company and the Supplee Hardware Company were united and incorporated as the Supplee-Biddle Hardware Company, and at that time Robert Biddle, 2d, became the general manager of the Supplee-Biddle Hardware Company.

II.

On February 14, 1917, Robert Biddle, 2d, was elected president of the plaintiff corporation by appropriate action of the board of directors, and assumed the presidency of said plaintiff company. He was 37 years of age, and at that time the oustanding capital stock of the plaintiff company was $800,000 par value and the annual sales were about $450,000.

III.

At the instance of the directors of the plaintiff company said Robert Biddle, 2d, on April 12, 1917, took out a policy of insurance on his own life, payable in the event of his death to the Supplee-Biddle Hardware Company as beneficiary, with the Provident Life & Trust Company in the principal sum of $50,000, and on
11 April 13, 1917, he took out an additional policy of insurance on his life with the Travellers Insurance Company in the principal sum of $50,000, payable to the Supplee-Biddle Hardware

Company in the event of his death. Both of said policies were for a term of five years, all the premiums being paid for the risk, and by the terms of the said policies the plaintiff was not to recover any of the premiums or any other principal sum except by reason of the death of said Robert Biddle, 2d. The premiums of said policies were paid by the plaintiff.

These insurance policies were taken out in good faith, the said Robert Biddle, 2d, being a good moral risk and in perfect physical health. The policies were taken out for the purpose of providing a fund to make secure the financial position of the company in the event of the death of the said Robert Biddle, 2d, and to indemnify the plaintiff against losses to its earning power which his death would occasion.

Robert Biddle, 2d, was a man of ability, energy, and initiative, and was so regarded in the hardware trade and by the banks with which the plaintiff dealt. At the time of his death there was no member of the plaintiff company who was qualified to take his place, and more than a year passed before a person could be found who was suitable to act as president of the company.

IV.

During the year 1918 said Robert Biddle, 2d, contracted influenza and died on the 12th day of October, 1918, he being at the date of his death 38 years of age. After his death the Provident Life & Trust Company paid, on October 22, 1918, to the Supplee-Biddle Hardware Company the sum of $50,073.78, and on the 28th day of October, 1918, the Travellers Insurance Company paid to the Supplee-Biddle Hardware Company the sum of $50,000. After deducting the premiums theretofore paid to said insurance companies in the sum of $2,126.50 the net proceeds of said policies amounted to the sum of $97,947.28.

V.

In accordance with the revenue act of 1918 the Supplee-Biddle Hardware Company made a return to the Commissioner of Internal Revenue of its income for the year 1918 showing a net income of $187,762.58, which said net income as so reported did not include the proceeds of said insurance policies in the sum of $97,947.28 received during said taxable year. Plaintiff when making its said return attached physically thereto a memorandum for their information of the Commissioner of Internal Revenue as follows:

"This return does not include $97,947.28, being the net proceeds of a life insurance policy upon the life of Robert Biddle, 2d, late president of this company, who died in October, 1918, as the company claims that the amount of the policy, less the premiums paid, being the amount above set forth, is not taxable."

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VI.

Upon a reexamination of plaintiff's tax return for the year 1918 the Commissioner of Internal Revenue added the proceeds of said

insurance policies, to wit, the sum of $97,947.28, to the net income as reported in its tax return and made other additions to the net income, not here material, increasing it to the sum of $296,221.44. Upon the submission of the original return plaintiff had paid a tax of $57,887.22, but because of the additions to the net income made by the Commissioner of Internal Revenue an additional tax was assessed in the sum of $93,991.26, and a penalty was added in the sum of $4,468.50 for negligence in not reporting formally the proceeds of said insurance policies, making in all an additional assessment of $98,459.76, which said sum plaintiff was required to pay and did pay under protest on January 8, 1921.

VII.

Because of the inclusion of the proceeds of said insurance policies, to wit, the sum of $97,947.28, as income, the plaintiff was required to pay a tax of $84,737.95 more than it would have had to pay had not the said proceeds of said insurance policies been included in and taxed as income.

VIII.

On the 29th day of March, 1921, plaintiff filed a claim for refund with the Commissioner of Internal Revenue, asking for the refund of said $84,737.95, which claim was by said commissioner rejected on the 14th day of September, 1921.

IX.

On the 22d day of July, 1921, plaintiff requested a reassessment of its taxes under section 328a of the revenue act of 1918, and the Commissioner of Internal Revenue, after making a comparison between the net income of the plaintiff and of companies doing a like kind of business, made a reassessment of plaintiff's taxes and returned to plaintiff on July 14, 1922, the sum of $29,584.06, together with interest. In making the reassessment of said taxes the Commissioner of Internal Revenue included the proceeds of said insurance policies above mentioned as income.

X.

The difference between the amount of tax paid on the proceeds of said insurance policy and the amount refunded because of the reassessment of its taxes amounts to $55,153.89.

XI.

No other action has been had on said claim in Congress or by any of the departments; no person other than plaintiff is the
13 owner thereof or interested therein; no assignment or transfer
of this claim, or any part thereof or interest therein, has been made; there are no credits or offsets; the plaintiff has at all times borne true faith and allegiance to the Government of the United States and has not in any way voluntarily aided, abetted, or given

encouragement to rebellion against the said Government. The plaintiff is a citizen of the United States.

Conclusion of law.

Upon the foregoing findings of fact the court decides as a conclusion of law that the plaintiff is entitled to recover. It is therefore adjudged and ordered that the plaintiff recover of and from the United States the sum of $55,153.89, with interest at the rate of 6 per cent per annum from January 8, 1921, amounting to $7,712.34, in all the sum of sixty-two thousand eight hundred and sixty-six dollars and twenty-three cents ($62,866.23).

Opinion.

HAY, Judge, delivered the opinion of the court.

This is a suit brought by the plaintiff to recover from the United States the sum of $55,153.89 as revised tax levied on the sum of $97,947.28, being the proceeds of two life insurance policies paid to the plaintiff on the death of its president, Robert Biddle, 2d, whose life had been insured by the plaintiff for its benefit.

It is admitted that Robert Biddle, 2d, the president of the plaintiff company, was the managing head of the company; that he was a business man of ability, energy, and initiative, and by reason of his business ability and the confidence which he inspired in those with whom he came in contact in his business he was a valuable asset to the plaintiff company. His activities in the business produced returns from the business which before his management of the company it had not earned. The death of such an executive head of the business would necessarily cause the company loss in income and in efficiency, and such loss and want of efficiency would continue until a president could be found who could take the place of the deceased president. It was the part of prudence in the plaintiff company to anticipate the possible loss which it might incur by insuring for its benefit the life of its president, and this it did by having Robert Biddle, 2d, take out two life insurance policies amounting to $100,000 payable to the plaintiff company and upon which the company paid the premiums. This action on the part of the plaintiff company was of the same character which causes prudent men to insure against loss by fire or against any other casualty which may overtake men engaged in business. Such being the character of the transaction, upon the death of Robert Biddle, 2d, do the proceeds of the insurance policies become taxable under the provisions of the revenue act of 1918, or are these proceeds to be regarded as indemnity for the loss incurred by the plaintiff company by reason of his death? If the latter, then the company should have not been required to pay the tax.

The revenue act of 1918 treated individuals separately from corporations, and the tax is levied separately, yet in defining the
14 "gross income" for corporations section 233 of the act provides: "That in the case of a corporation subject to the tax

imposed by section 230 the term 'gross income' means the gross income as defined in section 213." Section 213 reads as follows:

"That for the purposes of this title (except as otherwise provided in section 233) the term 'gross income'—

"(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; but—

"(b) Does not include the following items, which shall be exempt from taxation under this title: (1) The proceeds of life insurance policies paid upon the death of the insured to individual beneficiaries or to the estate of the insured." (40 Stat. 1057, 1065.)

It will be observed that no mention was made of the proceeds of life insurance in that part of the act dealing with corporations. The fact that in that part of the act dealing with individuals mention was made specifically of proceeds of life insurance can hardly be used to carry the implication that such proceeds must be regarded as income when they are received by corporations. It would be more logical to imply that as the act declared the proceeds of policies of life insurance was not income in the case of individuals the same definition of income applied in the case of corporations, and as the act had defined what income was in one case it was not necessary to define it in the other. Especially is this true when it is remembered that the definition of "gross income" is the same in both cases, and in construing the act with reference to the proceeds of insurance policies, whether individual or corporate, it would not be a strained construction to say that as the definition of "gross income" is the same in both cases the item of proceeds of insurance policies excluded in the one case is also excluded in the other—that it is not in fact an exemption but a definition of what is and what is not income within the meaning of the act, and to clinch the matter the revenue act of 1921 makes no distinction between individual and corporation life insurance policies.

Section 213 of that act now reads: "(b) Does not include the following items, which shall be exempt from taxation under this title:

(1) The proceeds of life insurance policies paid upon the death of the assured"; and consequently the Commissioner of Internal Revenue now holds that such proceeds paid to corporations are not taxable as income. (Reg. 62, art. 541, 1922.) It is thus seen that while it was held that such proceeds were taxable as income because they were not included under the provisions dealing with corporations in the act of 1918, yet they are now held not to be taxable as income notwithstanding the fact that the provisions of the act of 1921 dealing with corporations do not mention proceeds of life insurance; but because the words "to individual beneficiaries or the estate of the insured" are left out of the act of 1921 it is now held that the proceeds of life insurance policies are not income, although the provision is included under the provisions dealing with individuals. It would seem that if the proceeds of life insurance were taxable as income under the one act they would be taxable under the other, but a fair construction of the act of 1918 would seem to be that the proceeds of life insurance are not taxable as income whether the beneficiaries are individuals or corporations. And this construction is fortified by the action of Congress in the act of 1921 by eliminating the words "individual beneficiaries." The inference is clear that the intention of Congress was not to tax as income the proceeds of life insurance policies irrespective of the status of the beneficiary, whether individual or corporate.

We do not think Congress intended to tax the proceeds of life insurance policies as income, because such proceeds are not income in the accepted meaning of that word.

The word "income" means the gain which accrues from property, labor, or business. And the Supreme Court of the United States in the case of Merchants Loan & Trust Co. v. Smietanka, 225 U. S. 509, 518, has defined the meaning of the word "income" as follows: "Income may be defined as the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets."

It can not be said that the proceeds of life insurance policies come within the meaning of the above definition. It seems to us that in this case the contract of insurance was a contract to indemnify the plaintiff for the loss which it would incur by reason of the death of its president. The plaintiff company did not invest money with any expectation that it would receive a return from it. On the contrary, the money which it expended in paying the premiums on the policies might very well never have been returned to it; the probabilities were that the money would not have been returned, because the person insured had a much greater expectation of life than five years, the term of the policy. The money so paid out can not be considered an investment from which the company could expect an income.

The plaintiff is entitled to judgment; and it is so ordered.

GRAHAM, Judge; DOWNEY, Judge; BOOTH, Judge; and CAMPBELL, Chief Justice, concur.

16 VII. *Judgment of the court.*

At a Court of Claims held in the city of Washington on the twenty-eighth day of May, A. D. 1923, judgment was ordered to entered nunc pro tunc as of May 7, 1923, as follows:

The court, upon due consideration of the premises, find in favor of the plaintiff, and do order, adjudge, and decree that the plaintiff, as aforesaid, is entitled to recover and shall have and recover of and from the United States the sum of sixty-two thousand eight hundred and sixty-six dollars and twenty-three cents ($62,866.23).

BY THE COURT.

VIII. *Defendant's application for appeal.*

Filed July 6, 1923.

From the judgment rendered in the above-entitled cause on the 7th day of May, 1923, in favor of claimant, the defendants, by their Attorney General, on the 6th day of July, 1923, make application for, and give notice of, an appeal to the Supreme Court of the United States.

ROBERT H. LOVETT,
Assistant Attorney General.

IX. *Order of court allowing appeal.*

It is ordered by the court that the defendant's application for appeal be and the same is allowed.

BY THE COURT.

Entered July 6, 1923.

17 Court of Claims of the United States.

[Title omitted.]

Clerk's certificate.

I, F. C. Kleinschmidt, Assistant Clerk Court of Claims, certify that the foregoing are true transcripts of the pleadings in the above-entitled cause; of the argument and submission of case; of the findings of fact (as amended), conclusion of law, and opinion of the court by Hay, J., of the judgment of the court; of the defendant's application for appeal; of the order of the court allowing said appeal.

In testimony whereof I have hereunto set my hand and affixed the seal of said court at Washington City this eighteenth day of July, A. D., 1923.

[SEAL.] F. C. KLEINSCHMIDT,
Assistant Clerk Court of Claims.

(Indorsement on cover:) File No. 29,757. Court of Claims. Term No. 447. The United States, appellant, vs. The Supplee-Biddle Hardware Company. Filed July 21st, 1923. File No. 29,757.

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FILE COPY

No. 447. 13

In the Supreme Court of the United States

October Term, 1925.

United States, Appellant,

v.

The Supplee-Biddle Hardware Company,
Appellee.

APPEAL FROM THE COURT OF CLAIMS OF THE UNITED STATES.

MOTION TO ADVANCE.

WASHINGTON: GOVERNMENT PRINTING OFFICE: 1926

In the Supreme Court of the United States.

OCTOBER TERM, 1923.

UNITED STATES, APPELLANT,
v.
THE SUPPLEE-BIDDLE HARDWARE COMPANY, APPELLEE. } No. 447.

APPEAL FROM THE COURT OF CLAIMS.

MOTION TO ADVANCE.

Comes now the Solicitor General at the request of the Treasury Department and moves to advance the above-entitled cause for hearing at the earliest practical date during the present term.

The question involved is whether the proceeds of a life insurance policy payable to a corporation upon the death of one of its officers constitute income within the meaning of the Revenue Act of 1918 and the Sixteenth Amendment to the Constitution. The Court of Claims held in favor of the corporation.

The amount involved in this case is over $55,000, and other cases involving the same question are pending in the various Federal District Courts. It is estimated that if the instant case is decided by this Court adversely to the Government, approximately $355,000 must be refunded to taxpayers.

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In view of these circumstances and of the fact that the question which this case presents is continually arising in the audit of corporate returns under the Revenue Act of 1918, it is respectfully requested that the case be assigned for an early hearing.

Opposing counsel concur.

James M. Beck,
Solicitor General.

January, 1924.

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No. 447.

In the Supreme Court of the United States.

OCTOBER TERM, 1923.

THE UNITED STATES, APPELLANT,
v.
THE SUPPLEE-BIDDLE HARDWARE COMPANY.

APPEAL FROM THE COURT OF CLAIMS.

BRIEF FOR THE APPELLANT.

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CASES CITED.

In the Supreme Court of the United States.

OCTOBER TERM, 1923.

THE UNITED STATES, APPELLANT, *v.* THE SUPPLEE-BIDDLE HARDWARE COMPANY.	No. 447.

APPEAL FROM THE COURT OF CLAIMS.

BRIEF FOR THE APPELLANT.

The point involved in this case is whether the proceeds of a policy of life insurance, taken by a corporation upon the life of its president and paid to the corporation upon his death, is taxable income under the Revenue Act of 1918. The Court of Claims held that it was not, and the United States appeals.

THE FACTS.

The Supplee-Biddle Hardware Company was a Pennsylvania corporation engaged in the business of selling hardware and similar merchandise. It was organized about January 1, 1914, by a consolidation of the Biddle Hardware Company and the Supplee Hardware Company. At the time of the consolidation Robert Biddle, who had been associated with the Biddle Hardware Company since

the year 1899, became the general manager of the new company. On February 14, 1917, he was elected president and continued to hold that office until his death. He was at that time 37 years old, in perfect physical health, and a good moral risk. At that time the outstanding capital stock of the company was of the par value of $800,000, and its annual sales were about $450,000.

In April, 1917, at the instance of the directors of the company Mr. Biddle took out two policies of insurance upon his life, payable in the event of his death to the company as beneficiary. These policies were for $50,000 each and were for a term of five years. The premiums were paid by the company, and by the terms of the policies the company was not to recover any of the premiums or any other principal sum except by reason of the death of Mr. Biddle.

"The policies were taken out for the purpose of providing a fund to make secure the financial position of the company in the event of the death of" Mr. Biddle and to indemnify the company "against losses to its earning power which his death would occasion" (p. 5).

Mr. Biddle was a man of ability, energy, and initiative, and was so regarded in the hardware trade and by the banks with which the company dealt. At the time of his death there was no member of the company qualified to take his place, and it was more than a year before a person could be found who was suitable to act as president of the company.

On October 12, 1918, Mr. Biddle died of influenza. The proceeds of the policies were paid to the company and the net proceeds, after deducting the amount of the premiums paid, amounted to the sum of $97,947.28.

In filing its return for the year 1918 the company did not report as part of its income the proceeds of said policies, though it did attach to its return a memorandum setting forth the facts. Upon reexamination of the return an additional tax based upon the receipt of the proceeds of these policies was assessed, and after some further adjustments was paid. Appropriate relief was sought by claim for refund, and upon denial thereof suit was brought in the Court of Claims. That court rendered judgment against the United States for the sum of $55,153.89, with interest, and from that judgment the United States appeals.

THE STATUTE.

The statute involved is the Revenue Act of 1918 (Act of February 24, 1919), ch. 18, 40 Stat. 1057. Section 213 of the act, so far as it is material, provides as follows (p. 1065):

> That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—
>
> (a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the

United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits, and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; but

(b) Does not include the following items, which shall be exempt from taxation under this title:

(1) The proceeds of life insurance policies paid upon the death of the insured to individual beneficiaries or to the estate of the insured;

(2) The amount received by the insured as a return of the premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract;

(3) The value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included in gross income); * * *.

ARGUMENT.

I.

Under the terms of the Revenue Act of 1918 the proceeds of life insurance payable to corporate beneficiaries are taxable as income.

Part II of the Revenue Act of 1918, including section 213 already quoted, is headed "Individuals." Part III is headed "Corporations," and section 232 of the act, included in that title, provides that—

> "net income" means the gross income as defined in section 233 less the deductions allowed by section 234,

and section 233 (a) provides that:

> in the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in section 213,

with certain exceptions not material. Therefore, the definition of gross income in the case of a corporation is exactly the same as in the case of an individual. It would be difficult to employ language more universally inclusive than that used in section 213. It includes gains, profits, and income derived from any source whatever, and the specific mention of certain forms of income can not narrow the meaning of this all-inclusive language. It is the claim of the Government that the proceeds of these insurance

policies represented a gain, a profit, and an income growing out of the transaction of a business carried on for gain or profit. If the general language admits of any doubt, the specific language removes the doubt. That Congress, in all legislation passed since the Sixteenth Amendment, regarded the proceeds of life insurance policies as a form of income which they had authority to tax is shown by a comparison of the language used in the various acts. The first statute was the Act of October 3, 1913, ch. 16, 38 Stat. 114. Section II of that act, subdivision B, after defining in the most general terms the definition of income, contains this proviso:

> That the proceeds of life insurance policies paid upon the death of the person insured * * * shall not be included as income.

This was in the part of the Act relating only to individuals, and the Commissioner ruled that it did not include Corporations. T. D. 2090. Dec. 14, 1914.

The next act was the Act of September 8, 1916, ch. 463, 39 Stat. 756. Section 4 of that act provides:

> The following income shall be exempt from the provisions of this title: The proceeds of life insurance policies paid to *individual beneficiaries* upon the death of the insured * * *.

The Act of October 3, 1917, 40 Stat., ch. 63, p. 300, reenacted the provisions of the Act of 1916.

The proviso in the Act of 1918 is (section 213):

> The proceeds of life insurance policies paid upon the death of the insured to *individual beneficiaries or to the estate of the insured.*

In the Act of November 23, 1921, 42 Stat. 227, ch. 136, the proviso reads:

> The proceeds of life insurance policies paid upon the death of the insured.

It appears, therefore, that the question of the taxation of the proceeds of life insurance policies as income has been considered by Congress five times since the Sixteenth Amendment, and in each case they have been regarded as potential sources of income tax. In 1913 they were exempt when paid to individuals. In 1916 Congress inserted the words "paid to individual beneficiaries" and so expressly limited the exemption to such policies. This was continued in the Act of 1917. In the Act of 1918, however, another exemption appears, for, in addition to the proceeds of policies paid to individual beneficiaries, the exemption was made applicable to policies paid to the estate of the insured. In 1921 Congress returned to the provision in the original Act of 1913, which by the operation of section 233 made the proceeds of all life insurance policies exempt. In the face of this history of legislation and of these changes obviously made with deliberate intent, can there be any serious claim that the respective changes should not be given the full effect which their language imports? The intent is clear. First, the proceeds of life insurance policies were exempt when paid to individual beneficiaries, and this restricted exemption was continued until after the armistice. Then the exemption was further extended to include policies payable to the estate of

the insured, and finally, after the war was over and the necessity for extreme taxation had passed, the restrictions were wholly removed, and they are now wholly exempt.

The Court of Claims in construing the provisions of the Act of 1918 said (p. 8):

> It will be observed that no mention was made of the proceeds of life insurance in that part of the act dealing with corporations. The fact that in that part of the act dealing with individuals mention was made specifically of proceeds of life insurance can hardly be used to carry the implication that such proceeds must be regarded as income when they are received by corporations.

This language of the Court of Claims seems to disregard entirely the language of section 233, already quoted, which says that the term "gross income" means the gross income as defined in section 213. Language could not be plainer. The gross income of a corporation is, in so many words, defined in the same language as the gross income of an individual. The court continues:

> It would be more logical to imply that as the act declared the proceeds of policies of life insurance was not income in the case of individuals the same definition of income applied in the case of corporations, and as the act had defined what income was in one case it was not necessary to define it in the other.

In other words, the court seems to hold that to include the proceeds of the policies as income would be to tax by "implication." We claim, however, that the

proceeds of the policies are included by direct language and that the court has been forced to resort to implication in order to exclude them. Everything not excluded is taxed. Everything not specifically excluded is income. This income is defined in the broadest conceivable language, and then the statute says that it—

> Does not include the following items, which shall be exempt from taxation under this title.

Everything is included that the statute does not exempt, and the first item exempted is the proceeds of life-insurance policies paid upon the death of the insured to *individual beneficiaries or their estates.* Then follows several other exemptions: The amount received by the insured as a return of premiums paid by him under life-insurance, endowment, or annuity contracts; the value of property acquired by gift, bequest, devise, or descent; interest upon the obligations of a State, Territory, or any political subdivision thereof, etc.; amounts received through accident or health insurance or under workmen's compensation acts, etc. It seems to us that the construction of the act by the Court of Claims fails wholly to give effect to the words "individual beneficiaries or to the estate of the insured." This language surely has a different meaning from the language employed in the acts of 1913, 1916, and 1917. According to the reasoning of the Court of Claims these words have no meaning, and the act of 1918 means the same as the acts of 1913 and 1921.

It needs no specific language in the act making the proceeds of insurance policies payable to a corporation to be included in gross income, in order that they shall be taxable as income. They are to be included unless they are exempted, and the language exempting them applies only to policies paid to individuals and to estates.

Where a taxpayer claims an exemption from the operation of the law, such law is to be construed most strongly against him.

The case of *Commercial Health and Accident Co.* v. *Pickering*, 281 Fed. 539, contains a résumé of the decisions laying down this rule. In that case the court said (p. 541):

> It is contended by the plaintiff that in interpreting revenue laws courts should consider them strictly in favor of the citizen. *Eidman* v. *Martinez*, *supra*. This is undoubtedly the general rule applicable to the enacting clause of a statute. However, here plaintiff seeks to bring itself within a proviso or a clause exempting certain classes of corporations, associations, and clubs which the act provides shall not be burdened with the tax. In construing such a provision we must be guided by the rule, which has long been adhered to, and which is announced in *United States* v. *Dickson*, 15 Pet. 141, where the court uses this language:
>
> "* * * We are led to the general rule of law, which has always prevailed, and become consecrated almost as a maxim in the interpretation of statutes, that where the enacting clause is general in its language and objects,

and a proviso is afterwards introduced, that proviso is construed strictly, and takes no case out of the enacting clause which does not fall fairly within its terms. In short, a proviso carves special exceptions only out of the enacting clause; and those who set up any such exception must establish it as being within the words as well as within the reason thereof."

A claim of exemption from taxation must be clearly made out. *Bank of Commerce* v. *Tennessee*, 161 U. S. 134, 146; *Perry Co.* v. *Norfolk*, 220 U. S. 472; *Vicksburg R. Co.* v. *Dennis*, 116 U. S. 665.

The Court of Claims reasons that the fact that the Act of 1921 exempts the proceeds of all life insurance policies leads to the conclusion that such was the congressional idea in the Act of 1918. This, however, loses sight entirely of the difference in the language, which has already been pointed out. It is respectfully submitted that the omission of the words "individual beneficiaries" in the Act of 1921 does not amount to a legislative construction of the Act of 1918 and to a declaration that it was never the intention of Congress to attempt to tax such proceeds of insurance as income. *United States* v. *Field*, 255 U. S. 257; *Shwab* v. *Doyle*, 258 U. S. 529; *Smietanka* v. *First Trust & Savings Bank*, 557 U. S. 602. In *Shwab* v. *Doyle*, 258 U. S. 529, this court, Mr. Justice McKenna writing, said (p. 536):

> If Congress, however, had the purpose assigned by the commissioner, it should have declared it; when it had that purpose, it did declare it. In the Revenue Act of 1918, it

> reenacted section 202 of the Act of September 8, 1916, and provided that the transfer or trust should be taxed whether "made or created before or after the passage of" the act. *And we can not accept the explanation that this was an elucidation of the Act of 1916, and not an addition to it, as averred by defendant, but regard the Act of 1918 rather as a declaration of a new purpose;* not the explanation of an old one. [Italics ours.]

In the *Smietanka case* (257 U. S. 602, 606) this court said, Mr. Chief Justice Taft writing:

> This seems to us to graft something on the statute that is not there. It is an amendment and not a construction, and such an amendment was made in subsequent income-tax laws, as we shall see. * * *
>
> The Act of September 8, 1916, ch. 463, 39 Stat. 757, specifically declared that the income accumulated in trust for the benefit of unborn or unascertained persons should be taxed and assessed to the trustee. It is obvious that, in the acts subsequent to that of 1913, Congress sought to make specific provision for the *casus omissus* in the earlier act.
>
> This case is not unlike that of *United States* v. *Field*, 255 U. S. 257.

In the case of *New York Trust Company* v. *Eisner*, 256 U. S. 345, it was argued that Congress did not intend that State inheritance taxes should be included in the estate taxable under the Act of 1916, because by the amendment in the Act of 1918 they were specifically stated not to be deductible, but this court refused to sustain the contention. It seems to us,

however, that a conclusive answer to the inference drawn by the Court of Claims is found in the successive amendments to this feature of the law which we have before pointed out in the various acts from 1913 to 1921. Under each one of these Acts prior to 1921 the Commissioner of Internal Revenue has made rulings (T. D. 2090, T. D. 2519, and Regulations 45, Art. 294) construing the application of the exemption to individuals only and excluding corporations. Congress never saw fit to enlarge these rulings until 1921, and under the rule often expressed by this Court these rulings of the Commissioner must be treated as read into the statute. (*New Haven R. R.* v. *Interstate Com. Comm.*, 200 U. S. 401.)

II.

Proceeds of life insurance policies on the lives of officers of a corporation taken out by it for its benefit constitute income within the meaning of the Sixteenth Amendment when received by the corporation.

The Court of Claims holds not merely that proceeds of these policies were not intended by the Act of Congress to be included as income, but also holds that they were not income within the legal definition of the word as given by this court in the case of *Merchants Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509, 518. In that case the court said:

> Income may be defined as the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets.

This definition was somewhat elaborated in the case of *United States* v. *Phellis*, 257 U. S. 156, but these definitions must be construed with reference to the facts then under consideration. In the *Smietanka case* the question related to the gains or profits derived by the sale by a testamentary trustee of the personal property of the estate which had appreciated over its market value of March 1, 1913, and in the *Phellis case* the question related to securities received by the taxpayer upon a reorganization of a corporation in which he was a stockholder. There is nothing in these cases which holds that a gain received by a corporation in cash, as a result of a cash investment—an increase in the book value of its tangible assets by reason of the exercise of intelligence, foresight, and skill in the expenditure of money by its officers—is not income. When this court said that income was "gain derived from capital, from labor, or from both combined," it did not intend to exclude the effect of brains prudently and thoughtfully applied. If the sum of $97,000 obtained by a corporation as the result of an expenditure of $2,000 was not gain, what was it? Gain is income, unless it is an unrealized and unsevered increment of capital. When this money was received by the corporation from the insurance companies, it must have been entered upon the corporate books, and we know of no place to enter it except upon its capital account or upon its income account. It did not result from the sale of capital stock or of assets theretofore carried in its capital

account. It did not represent a mere marking up of book value of fixed assets, as in the case of real estate. When the premiums on these policies were paid the cash account must have been credited and some account debited, and when the proceeds of the policies were received by the company the cash account must have been debited and the other account credited, and the difference, we submit, should have been carried into the profit and loss account as a profit. But the Court of Claims reasons that the contract of insurance was a contract to indemnify the plaintiff for the loss which it would incur by reason of the death of its president and says:

> The plaintiff company did not invest money with any expectation that it would receive a return for it.

If this company did not invest the money with any expectation of receiving a return from it, for what purpose did it invest it and what right did it have to make the expenditure? It certainly was not a contribution to charity, and possibly it is too broad a statement to say that it did expect a return in money. It was a prudent, sagacious investment, and only the result could determine whether it would be profitable or not. In other words, it was like many other wise and prudent expenditures. It was a case of corporate bread upon the waters and the return came more quickly than was anticipated. If, as the Court of Claims says, it was a contract of indemnity, against what did the company seek to be indemnified?

Against the death of its president of course, but if the president had died without the contract of indemnity, could the corporation have charged off anything by way of depreciation, amortization, obsolescence, or depletion? It is to be noted that there is no finding to the effect that Mr. Biddle was under contract with the company to remain in its service. He could have left at any time. The directors could have displaced him at any time or he might have become incapacitated by illness. No stock had been issued against him as a capital asset. He was not carried on their books as an asset. His death made no change which the law could recognize in the assets, liabilities, or capitalization of the company. The only fact shown by the books of the corporation as the result of his death was an increase in its cash assets from the proceeds of these insurance policies. The question presented is quite different from that of insurance against fire or other casualty. When property is destroyed by fire, earthquake, flood, or tornado, a taxpayer is allowed to deduct as a loss the value of the property destroyed unless it is insured. Then he is entitled to deduct only such loss as is not covered by the indemnity. Cash received under such circumstances as indemnity for losses is not of course income. It merely prevents the writing off of a loss and makes good assets representing previous expenditures of capital. If the policies be regarded as indemnity for loss of profits which the company might expect to receive had he continued to live, this result would follow: Had he lived and

the company earned the profits, they would have been taxable and the Government would have received its tax thereon. When he died the company received the profits all at once and it was equally taxable. Why should the Government be deprived of the tax which it would have received upon these prospective profits when, by reason of the business prudence of the directors, the corporation received the profits as a result of his death?

Life insurance, ordinarily speaking, is not a contract of indemnity. To be sure, the element known as an insurable interest has been long regarded as necessary to the validity of an insurance contract. The principle was formulated in the English courts soon after the idea of life insurance became a general feature of modern life, and was regarded as essential in order to take the contract out of that class known as wagering contracts and in order that public policy might be satisfied. The insurable interest, however, although essential in the inception of the contract, need not continue throughout its life. This court in the case of *Connecticut Mutual Life Insurance Co.* v. *Schaefer*, 94 U. S. 457, 461–462, speaking by Mr. Justice Bradley, said:

> We do not hesitate to say, however, that a policy taken out in good faith, and valid at its inception, is not avoided by the cessation of the insurable interest, unless such be the necessary effect of the provisions of the policy itself. Of course, a colorable or merely temporary interest would present circumstances

from which want of good faith and an intent to evade the rule might be inferred. And in cases where the insurance is effected merely by way of indemnity, as where a creditor insures the life of his debtor, for the purpose of securing his debt, the amount of insurable interest is the amount of the debt.

But supposing a fair and proper insurable interest, of whatever kind, to exist at the time of taking out the policy, and that it be taken out in good faith, the object and purpose of the rule which condemns wager policies is sufficiently attained; and there is then no good reason why the contract should not be carried out according to its terms. This is more manifest where the consideration is liquidated by a single premium paid in advance than where it is distributed in annual payments during the insured life. But, in any case, it would be very difficult, after the policy had continued for any considerable time, for the courts, without the aid of legislation, to attempt an adjustment of equities arising from a cessation of interest in the insured life. A right to receive the equitable value of the policy would probably come as near to a proper adjustment as any that could be devised. But if the parties themselves do not provide for the contingency the courts can not do it for them.

The logical answer to the argument that these insurance proceeds are not taxable because they are indemnity is that they are indemnity against a loss that would not be deductible. They are therefore

gain. If the taxpayer receives insurance to compensate him for a loss that is not recognized by the statute, he must account for a gain, because his capital remains intact and he has acquired something of a money value in addition. Of course, speaking colloquially, it is frequently said, and is undoubtedly true, that the services of a given individual are an asset to the firm or corporation with which he is connected, but no such colloquial conception of the relation between the individual and the corporation can be accepted here in order that the respondent may recover on the theory that what it receives was a reimbursement for the loss of a capital asset. We are not concerned with the colloquial use of the term. We are concerned merely with the question of corporate accounting with reference to a taxing statute. Looking at the service of respondent's president in this light, stripped of all elements of sentiment, it is clear that they do not stand the tests to be applied in ascertaining whether or not his services were a capital asset. If the corporation had bound Mr. Biddle by contract to serve with them for a definite number of years, and if the laws of the State under which the corporation was organized permitted it, it might be that that contract could have been carried upon the corporate books as an asset and possibly as a consideration for the issuing of stock. Under such circumstances, had the corporation taken out a policy of insurance upon his life it would seem to be reasonable to hold that upon his death the proceeds of the policy might have been used to

make good the loss represented by the stock issued or the capitalized value of the contract. But that is not the present case, and under no principle of law or of accounting with which we are familiar could the mere fact that he was an able, skillful, and successful man be treated as a corporate asset having a cash value. The ordinary idea of an asset excludes everything that may not be used in some form or another by a corporation to liquidate its liabilities. In *Marvin* v. *Mayesville Street R. R. & Transfer Co.*, 49 Fed. 436, 437, the court discussing what were assets of a decedent, referred to the definition of Mr. Justice Story, in the following language:

> In an accurate and legal sense, all the personal property of the deceased, which is of a salable nature, and may be converted into ready money, is deemed "assets." But the word is not confined to such property; for all other property of the deceased which is chargeable with his debts or legacies, and is applicable to the purpose, is, in a large sense, assets.

Of course, the proportion between the tax which the respondent was required to pay and the amount of the proceeds of the policies seems to be so disproportionate as to make one reluctant to sustain the tax. That, however, is not a consideration for the court. The taxes imposed during the war were the most drastic ever heard of in this country, and in many cases they resulted in real hardship and seeming injustice. The respondent, subject to both the income and the excess profits tax, was, by reason

of the relation between its capital and its income, subject to taxation in the higher brackets. Nevertheless, taxation at these rates was fixed by the act, and this company was in no different position from thousands of other companies. Any argument based upon the size of the tax is an appeal to sympathy, not to law.

CONCLUSION.

Congress had the power to levy a tax upon incomes from whatever source derived.

The Revenue Act of 1918 included in gross income the proceeds of life insurance policies except those specifically exempted—that is, those payable to an individual or to his estate. The policies in question were not so payable, but were payable to a corporation and became part of its income for the taxable year. Had Mr. Biddle lived, the income resulting from his management would have been taxable under the Sixteenth Amendment, which provides for taxes on incomes from whatever source derived, and the proceeds of the policies took the place of that income.

The judgment of the Court of Claims should be reversed.

Respectfully submitted.

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Solicitor General.

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Special Assistant to the Attorney General.

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March, 1924.

O

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1923.

No. 447.

THE UNITED STATES, *Appellant*,

v.

THE SUPPLEE-BIDDLE HARDWARE COMPANY,

On Appeal from the Court of Claims.

BRIEF FOR APPELLEE.

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IN THE

Supreme Court of the United States

October Term, 1923.

The United States,
Appellant,

vs.

The Supplee-Biddle Hardware Company.

No. 447

BRIEF FOR APPELLEE.

Statement.

On September 23, 1922, appellee filed its petition in the Court of Claims, praying for the recovery of $55,153.89, with interest, as taxes erroneously and illegally assessed and collected by the United States on the proceeds of a life insurance policy paid to it as a corporate beneficiary at the death in 1918 of its president (R., pp. 1-3). On May 7, 1923, the Court of Claims handed down its findings of facts (R., pp. 4-7) and opinion (R., pp. 7-9) and gave judgment for the plaintiff (appellee).

In its opinion, the Court held that the act of Congress (Revenue Act of 1918) by virtue of

which this tax was levied and collected, did not purport to tax the proceeds of life insurance policies; and, further, that the proceeds of life insurance do not constitute "income" within the scope of the definition of that term as laid down by this Court in *Merchants Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509-518.

The United States has appealed from the judgment of the Court of Claims.

The Facts.

Appellee, the Supplee-Biddle Hardware Company, was the successor in business of two old established hardware firms in the city of Philadelphia (Finding I, p. 4). About January, 1914, they were merged and incorporated as the Supplee-Biddle Hardware Company and conducted business thenceforth as a single concern.

During February, 1917, Robert Biddle, 2nd, was elected president of the corporation, he being at that time thirty-seven years of age (Finding II, p. 4). He had gone to work with the Biddle Hardware Company at the age of eighteen and had held various offices previous to his being elected president of the merged company (Finding I, p. 4). He was "a man of ability, energy and initiative, and was so regarded in the hardware trade and by the banks with which the plaintiff dealt" (Finding III, p. 5).

In 1917, at the instance of the Board of Directors of the company, Robert Biddle, 2nd, took out two policies of insurance in the principal sum of $50,000 each, payable to the corporation in the event of his death. "These policies were taken out in good faith, the said Robert Biddle,

2nd, being a good moral risk and in perfect physical health. The policies were taken out for the purpose of providing a fund to make secure the financial position of the company in the event of the death of the said Robert Biddle, 2nd, and to indemnify the plaintiff against losses to its earning power which his death would occasion'' (Finding III, pp. 4-5).

In the Court's opinion (p. 7), Judge Hay says: ''It is admitted that Robert Biddle, 2nd, the president of the plaintiff company, was the managing head of the company; that he was a business man of ability, energy, and initiative, and by reason of his business ability and the confidence which he inspired in those with whom he came in contact in his business, he was a valuable asset to the plaintiff company. His activities in the business produced returns from the business which before his management of the company it had not earned. The death of such an executive head of the business would necessarily cause the company loss in income and in efficiency, and such loss and want of efficiency would continue until a president could be found who could take the place of the deceased president. It was the part of prudence in the plaintiff company to anticipate the possible loss which it might incur by insuring for its benefit the life of its president, and this it did by having Robert Biddle, 2nd, take out two life insurance policies amounting to $100,000 payable to the plaintiff company, and upon which the company paid the premiums. This action on the part of the plaintiff company was of the same character which causes prudent men to insure against loss by fire or against any

other casualty which may overtake men engaged in business.''

In 1918, when Robert Biddle, 2nd, was thirty-eight years of age, he contracted influenza and died. As the result of his death, the two insurance companies discharged the obligations of their policies; consequently, the appellee, after deducting premiums paid, received in the year 1918 as the net proceeds of the life insurance policies the sum of $97,947.28 (Finding IV, p. 5).

The company did not consider these proceeds as taxable income and therefore omitted them from the income reported as taxable for the year 1918; although to establish good faith, the company attached a memorandum to the return, disclosing that it had received this sum and its source for the information of the collector (Finding V, p. 5).

The Commissioner of Internal Revenue accordingly ordered a re-examination of appellee's return and included the proceeds of the insurance received to be included in income for 1918 and taxed (Finding VI, pp. 5-6).

The result was that appellee was forced to pay a tax of $84,737.95 on the proceeds, $97,-947.28, which it had received (Finding VII, p. 6).

The Commissioner of Internal Revenue, considering this enormous tax on the proceeds highly inequitable, reduced appellee's taxes by $29,-584.06, in accordance with the powers conferred upon him by Section 328 of the Revenue Act of 1918 to reduce the rate of taxation in cases of unusual hardship (Finding IX, p. 6).

There remained the sum of $55,153.89, however, which represented taxes which appellee had

paid solely because of the inclusion of these insurance proceeds in income (Finding X, p. 6) and for this sum, together with interest from the time the tax was paid under protest, the Court of Claims gave judgment (Conclusion of Law, p. 7).

The Questions Involved.

Under the facts found in this record, the questions presented to this Court are:

A. Are the proceeds of life insurance policies when paid to a corporation beneficiary, upon the death of an officer which it has insured for its benefit, taxable as income to it?

1. Are the proceeds of life insurance policies "income" within the meaning of that term as used in the Sixteenth Amendment to the Constitution of the United States?

2. Does the Revenue Act of 1918 (Act of Feb. 24, 1919, 40 Stat. 1057, c. 18), when properly construed, tax the proceeds of life insurance policies as "income"?

In discussing the above questions, we will begin with the question of the proper construction of the Revenue Act of 1918, in order to acquaint the Court with the act, the history of income tax legislation, and the construction placed upon it by the Treasury Department; although the constitutional question involved is the more im-

portant because of the fact that taxpayers quite generally believe that the proceeds of life insurance are not income within the Constitutional sense. The case is one of first impression for the industry of counsel has failed to disclose a case directly in point or in fact any case where the essential nature of life insurance proceeds has been considered in connection with the income tax laws, or the constitution.

I.

The proceeds of life insurance are not within the definition of gross income as found in Section 213 of the Revenue Act of 1918 and such proceeds are not taxable under said Act.

In considering the proper construction of the Revenue Act of 1918, the plan of the act should first of all be noticed. The net income which is the subject of the tax is arrived at by defining "gross income" and subtracting therefrom certain specified deductions. In defining gross income, Congress specified what it should include and what it should not include.

Congress further divided the act into two parts; one dealing with individuals and the other with corporations.

Gross income for individuals is defined in Section 213 of the Act, from which can be taken the deductions authorized in Section 214.

Gross income for corporations incorporates by reference the definition of gross income as set out in Sec. 213 (for individuals), and from that certain deductions set out may be taken by corporations. This explanation is only important so

far as it bears upon the interpretation to be given the word "individual", which appears in paragraph b-1 of Sec. 213, relating to individuals.

Section 213, so far as it is pertinent, reads as follows:

That for the purposes of this title * * * the term "gross income"

> "(a) includes gains, profits and income derived from salaries, wages or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits *and* income derived from any source whatever * * *; but
>
> (b) does not include the following items, which shall be exempt from taxation under this title:
>
> (1) The proceeds of life insurance policies paid upon the death of the insured to *individual* beneficiaries or to the estate of the insured." (Italics ours.)

In the remainder of the statute having to do with the tax on corporations, no mention is made of the proceeds of life insurance policies, so that nowhere in the statute is there any language used directly taxing such proceeds.

Nevertheless, the Treasury Department in construing this statute, held that the proceeds of insurance policies paid to a corporation beneficiary were taxable and issued regulations in

accordance with that view. Regulations 45, Art. 541. The conclusion of the Treasury was obviously arrived at because of the exemption of the proceeds of life insurance policies paid to *individuals* and *estates* as provided for in paragraph (b), the proviso, and thereby construing by *implication* that paragraph (a) the enacting clause, taxes the proceeds of all life insurance policies, notwithstanding that such proceeds are not mentioned or even approximately described in paragraph (a).

Nothing is better settled than that a taxing statute is not to be construed as levying a tax by implication. In *Gould* v. *Gould*, 245 U. S. 151, Mr. Justice McReynolds said:

> "In the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations *so as to embrace matters not specifically pointed out*. In case of doubt they are construed most strongly against the government, and in favor of the citizen. *United States* v. *Wigglesworth*, 2 Story, 369, Fed. Cas. No. 16,690; *American Net & Twine Co.* v. *Worthington*, 141 U. S. 468, 474; *Benzinger* v. *United States*, 192 U. S. 38, 55." (Italics ours.)

The Treasury regulation attempts to construe paragraph (a), the enacting clause, as *embracing matters not specifically pointed* out solely because of the implication in paragraph (b), the proviso.

It will be noted that the proceeds of life insurance policies are not within the scope, even remotely, of the descriptive words used in paragraph (a), the enacting clause. They are cer-

tainly not "gains, profits and income derived from salaries, wages or compensation for personal service", nor from professions nor from business transactions carried on for gain or profit. The only phrase in paragraph (a) which could possibly be used as a peg upon which to hang this tax would be the phrase at the conclusion of the definition, "or gains or profits and income derived from any source whatever." Nor does the government point out any language in paragraph (a) descriptive of life insurance proceeds.

Under the ordinary rules of statutory construction, however, this phrase would be construed as inclusive of the objects selected for the tax by the legislature, and under the doctrine of *ejusdem generis* would not be expanded to include matters other than those which the legislature or Congress had undertaken to specify. As was pointed out, in construing similar provisions of the 1913 Act (38 Stat. 114, 166, c. 16) in *Gould* v. *Gould* 245 U. S. 151:

> "The use of the word itself in the definition of 'income' causes some obscurity, but we are unable to assert that alimony paid to a divorced wife under a decree of court falls fairly within any of the terms employed."

It is our purpose to point out in the second part of this brief that life insurance proceeds are not comprehended in the definition of income as applied to the Sixteenth Amendment, but it is sufficient for our present purpose to call attention to the fact that Congress is not obliged to use the word income as taxing everything that might

be taxed under the Constitution; and, therefore, there can be no presumption that because of the use of the word "individual" in paragraph (b), the proviso, that there was any intent to tax more than the descriptive words in paragraph (a), the enacting clause, fairly imply. In *Towne* v. *Eisner*, 245 U. S. 418, Mr. Justice Holmes said:

> "But it is not necessarily true that income means the same thing in the Constitution and the Act. A word is not a crystal, transparent and unchanged, it is the skin of a living thought and may vary greatly in color and content according to the circumstances and the time in which it is used. *Lamar* v. *United States*, 240 U. S. 60."

In that case the question was whether stock dividends were taxable under the 1913 Act, where stock dividends as such were not mentioned in the Act, and the Act was construed as not taxing stock dividends, although the phrase "income derived from any source whatever" appeared in that Act. This Court subsequently disagreed as to how far the decision in that case went (*Eisner* v. *Macomber*, 252 U. S. 189), but we have no doubt that it is authority for the point on which we cite it.

The words used in paragraph (a), the enacting clause, are general ones and words in popular use. To the ordinary citizen they would imply gains or profits made in ordinary business transactions, either through employment, barter or investment. They would not be thought as embracing matters which are not usually thought of as business transactions. Congress was willing to post its pickets some distance from the

constitutional frontier and the language used would ordinarily be so understood.

As a matter of fact, to construe the section as taxing the proceeds of insurance casts upon Congress an intent to regard such proceeds as both capital and income, an anomaly which, unless avoided, is fraught with serious dangers to the taxing statutes. Under the Estate Tax Law enacted at the same time (Act of Feb. 24, 1919, C. 18, Sec. 401), Congress by Sec. 402 thereof has expressly included in the gross estate of the decedent the proceeds of life insurance policies received by the executor which the deceased had taken out on his own life, and also the proceeds received by all other beneficiaries, subject to an exemption of $40,000. If such proceeds are subject to the estate tax, it must be that Congress considered them as equivalent to an asset passing at the time of death. If such proceeds are income as the Treasury holds, and taxable as such, except for the beneficent exemption allowed by Congress, how can they at the same time be part of the corpus of the estate of a decedent? The theory of the estate tax is that Congress has the power to tax the transfer of the estate. *Knowlton* v. *Moore*, 178 U. S. 41. The estate is considered as property, *i. e.*, capital, and cannot be taxed as such without encountering the prohibition against direct taxes. Congress, therefore, regarded such proceeds as a part of the corpus of the estate passing at the time of death. Such proceeds were in the nature of a devise or bequest which Congress directed in Sec. 213 (b) (3) should not be included in income.

But without attempting to reconcile these divergent concepts of the nature of insurance

proceeds for the time being, our point is that by *expressly* taxing such proceeds as part of a decedent's estate and not as income to it, it is a clear indication that Congress did not intend to include such proceeds in the purview of Section 213 (a) *supra* as "income."

And, furthermore, the provisions of the Estate Tax Law clearly explain the purpose of Section 213 (b), the proviso, in exempting such proceeds to individuals and estates in order to guard against any interpretation of Sec. 213 (a), the enacting clause, which would result in double taxation or invalidate its expressed intention of including such proceeds in the gross estate of a decedent and taxable upon the transfer of that estate by reason of death. Corporations are not ordinarily beneficiaries of an estate, and are not as a rule beneficiaries of life insurance policies which might be taken out to avoid the estate tax. As a means of avoiding the estate tax the resort to insurance is obvious. Consequently, the omission of the word "corporation" is better explainable as an oversight than any implied construction of Sec. 213 (a). Sec. 402 of the Estate Tax Law of 1918 provided that there should be included in the "gross estate":

> "And to the extent of the excess over $40,000 of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life."

There is, therefore, no distinction in the Estate Tax Law between the beneficiaries, whether individual, corporate or the estate, so that if the Commissioner of Internal Revenue is right the

proceeds of insurance payable to a corporation beneficiary would be subject to both income and estate taxes, a construction of the entire act which should be avoided if there is any other reasonable interpretation. And this notwithstanding that the value of property acquired by "gift, bequest, devise or descent", is excluded from Sec. 213 (a) by Sec. 213 (b) (3).

It is argued by the government that the history of income tax legislation is in accordance with the Treasury interpretation of this law with respect to these proceeds. But with this argument we disagree.

Beginning in 1861 and ending in 1894, a series of ten income tax acts were passed, the last one meeting with the fate of being declared unconstitutional (*Pollock* v. *Farmers' Loan & Trust Co.*, 158 U. S. 601); although this court had previously apparently sustained the constitutionality of a similar act of 1865. *Springer* v. *U. S.*, 102 U. S. 586. These acts were the following[1]:

Act of Aug. 5, 1861, 12 Stat. 292-313.
Act of July 1, 1862, 12 Stat. 432-489.
Act of March 3, 1863, 12 Stat. 713-731.
Act of June 30, 1864, 13 Stat. 223.
Act of March 3, 1865, 13 Stat. 469.
Act of March 10, 1866, 14 Stat. 4-5.
Act of July 13, 1866, 14 Stat. 98-173.
Act of March 2, 1867, 14 Stat. 471-487.
Act of July 14, 1870, 16 Stat. 256-262.
Act of Aug. 15, 1894, 28 Stat. 553-69.

In referring to these acts we can trace the general evolution of the definitions finally ap-

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[1] These early acts, together with subsequent income tax laws, are collected in Federal Income Tax Laws, Barton & Browning (John Byrne & Co., Washington).

pearing in Sec. 213 (a). The Act of Aug. 5, 1861, for example, provides:

> "That from and after the first day of January next, there shall be levied, collected, and paid, upon the *annual income* of every person residing in the United States, whether such income is derived from any kind of property, or from any profession, trade, employment, or vocation carried on in the United States or elsewhere, *or from any source whatever,* if such annual income exceeds the sum of eight hundred dollars, a tax, etc. * * * (Italics ours.)

At this point we wish to interpolate our argument for the purpose of calling attention to the fact that the phrase "income—from any source whatever," which, as we have said, appears to us to be the only phrase which could possibly be expanded to include the proceeds of life insurance policies, appears in the first act and was evidently intended as a declaration that the source of the income, even if it were land, for example, would not subject it to exemption from the tax. It was an attempt to avoid the Constitutional limitations against a direct tax and not for the purpose of enlarging the scope of the subject matter described. This is apparent in the first act, where the word "income" is separated from the rest of the phrase concerning the source. It was later decided in the *Pollock* case (158 U. S. 601) cited *supra,* that income could not be taxed regardless of source, and the result of it all was the language finally employed in the Sixteenth Amendment. The obvious purpose was to tax income from trade, employment or property, without regard to the source being prop-

erty, for instance, but not to tax income from any other source than those mentioned.

To return to the acts cited above, however, it will be found that the sections defining income are enlarged until they are in substantially the same form as Sec. 213 (a) of the 1918 Act. And yet in none of these acts is there any mention made of the proceeds of life insurance policies, nor any attempt to tax such proceeds directly or indirectly. These Acts originated during the Civil War when the need for money was as acute as during the World War, and the desire to obtain money by taxation just as extreme; but, whereas the terms used in the definition of what was to be taxable as income were constantly increasing from year to year, no attempt was made to tax the proceeds of insurance.

Under these acts the only reference to the subject of insurance proceeds is an instruction issued by the Commissioner of Internal Revenue advising collectors that insurance proceeds were not taxable as income. This was a Treasury decision of March 9, 1867, which is reported in the Internal Revenue *Record* (N. Y.) issue of April 6, 1867. This publication is to be found in the Congressional Library, but we have been unable to find any official reports of that period, although it is referred to in Treasury *Digests*. The ruling was a construction of the Act of 1867, which provided:

> "That there shall be levied, collected, and paid annually upon the gains, profits, and income of every person residing in the United States, or of any citizen of the United States residing abroad, whether derived from any

> kind of property, rents, interest, dividends or salaries, or from any profession, trade, employment or vocation, carried on in the United States or elsewhere, or from any source whatever, a tax, etc."

So far as our investigation has gone this ruling applied as to all the income tax laws, and apparently in its research the Government has not discovered any contrary ruling, so that up until the time of the adoption of the Sixteenth Amendment these acts, by long, continued interpretation by the Treasury Department, have been construed as not taxing the proceeds of insurance. This construction is entitled to great weight.

> *Kern River Co.* v. *U. S.*, 257 U. S. 147-154.
>
> *Grand Trunk Western R. Co.* v. *U. S.*, 252 U. S. 112-121.
>
> *U. S.* v. *Alabama G. S. R. Co.*, 142 U. S. 615.

Following these acts no further income tax laws were passed, except the Corporation Excise Tax Law, which measured the tax by the income of the corporation (Act of August 5, 1909, 36 Stat. 113-18, C. 6), until after the adoption of the Sixteenth Amendment. This act applied specifically to corporations and no attempt was made by its terms to tax life insurance proceeds.

As this Court has often decided, the effect of the Sixteenth Amendment was not to enlarge the definition of income, but simply to remove the constitutional objection to the taxing of income from a source which itself could not be taxed

under the Constitution. In *Peck* v. *Lowe*, 247 U. S. 165-172, the Court said:

> "As pointed out in recent decisions, it (the 16th Amendment) does not extend the taxing power to new or excepted subjects, but merely removes all occasion, which otherwise might exist, for an apportionment among the states of taxes laid on income, whether it be derived from one source or another."

We have, therefore, at the time of the adoption of the Sixteenth Amendment, a settled construction that language of practically the same import as that used in Section 213 (a), the enacting clause, of the Act of 1918, did not comprehend the inclusion of the proceeds of life insurance in the term "income." And what the word meant at the time of the adoption of the Sixteenth Amendment is the constitutional frontier beyond which Congress may not go. *Eisner* v. *Macomber*, 252 U. S. 189; *Merchants Loan etc.* v. *Smietanka*, 255 U. S. 509-518-519.

When we reach the constitutional question we will argue that the fixed construction of these acts excludes the proceeds of life insurance policies from the definition or conception of income at the time of the adoption of the Sixteenth Amendment. For the present we are content to urge that the settled construction of the language employed in the former acts is persuasive of the proper construction of Sec. 213 (a) of the Act of 1918. The statutes being in *pari materia* and further the evolution of a taxing scheme, the construction of the language in the earlier statutes should settle the construction to be placed on the later statutes.

It is only after the adoption of the Sixteenth Amendment that we find any reference to the proceeds of life insurance policies, and then only as deductions from the gross income defined in general terms in the enacting clause. The general definition of income is, with minor modifications, of the same purport in the following acts passed since the amendment.

Sec. B-1, Act of October 3, 1913 (38 Stat. 166-81, C. 16).
Sec. 2(a), Act of Sept. 8, 1916 (39 Stat. 756-7, C. 463).
Sec. 1200 (1) Act of Oct. 3, 1917 (40 Stat. 300-38, C. 63).
Sec. 213(a) Act of Feb. 24, 1919, (*re* Stat. 1057-96, C. 18), known as the 1918 Act.
Sec. 213 (a) Act of Nov. 23, 1921 (42 Stat. 227-321, C. 136).

The 1913 Act provided that the proceeds of life insurance policies *should not be included as income.* No mention was made in this act of any exemption, a word loosely used in the subsequent acts, as for example the "exemption" of "interest on the obligation of any state" in the 1917 Act.

The acts of 1916 and 1917 "exempted" the proceeds of insurance policies paid to individual beneficiaries, and the 1918 Act extended the exemption to estates. These acts also "exempted" the income from state obligations, which were obviously not taxable income, and also property acquired by gift, bequest, devise, or descent. It seems obvious that Congress would not have the

power to levy a direct tax on legacies by virtue of any power given it to levy income taxes; and, therefore, the use of the term "exempt" seems inapt, for a taxpayer could demand the exclusion of a devise or bequest from taxable income by way of right and not by grace of Congress.

The 1921 Act exempted the proceeds of insurance paid upon the death of the insured. Ordinarily a change made in a subsequent act of Congress may have little weight as a legislative construction of a former act, as is pointed out in the government brief, but this change we assert has weight because of the ambiguity in the 1916, 1917 and 1918 acts, and because of the fact that the construction of the Treasury was at odds with the settled policy of Congress. The facts in this case show the length of time it would take for the Treasury Department to make a determination of any given case, the tax on the life insurance proceeds in this case having been exacted on January 8, 1921, almost two years after the return was due and less than a year before Congress passed the 1921 Act, so that it is reasonable to suppose that Congress at the first opportunity hastened to correct an erroneous construction.

Consequently, we reiterate that the history of income tax legislation in the United States shows without question that language of the general import of that used in Sec. 213 (a) was never thought to include the proceeds of life insurance policies, and when the Treasury Department departed from long continued construction, Congress, at the first opportunity, corrected that interpretation.

It is said in the government brief that appellee is trying to bring itself within an exemption to the tax imposed by the act and that therefore the burden is upon appellee to establish the exemption. But this argument is an attempt to turn the coat inside out. The question involved is the proper construction of Sec. 213 (a)—whether life insurance proceeds are taxed by the general language of that section. The burden is on the government to show that this section embraces matters not specifically pointed out. *Gould* v. *Gould*, 245 U. S. 151. It, in effect, tries to do so by assuming that there is an *implication* of the proper construction in Section 213 (b) (1). Our reply is that you cannot construe a statute as levying a tax by implication. Appellee is not trying to bring itself within any exemption granted by paragraph (b) (1). If paragraph (a), the enacting clause, can be construed as taxing life insurance proceeds, appellee has no disposition to argue that it is exempt from that tax because of the language of paragraph (b) (1). Its contention is simply that the scope of paragraph (a) cannot be enlarged by any implication contained in paragraph (b). Without that implication, as has been shown, by considering the income tax legislation historically and also by considering it in relation to other taxing acts in *pari materia,* it is not susceptible of the construction placed on it by the Treasury.

By a fair construction we think that the intent of paragraph (b) was not to grant exemptions, but declaratory of items which were not to be included in income because they were not income under any consideration. If paragraph (b) has

the force which the Treasury gives it, then Congress has included in paragraph (a), except for its grace in granting an exemption, interest on municipal bonds, interest on Federal obligations which were issued as tax exempt, the return of insurance premiums, the value of property acquired by gift, devise or descent and the proceeds of life insurance policies. Certainly to construe Section 213 (a) as taxing the income of municipal bonds in the absence of the exemption would be to impute an absolutely unwarranted construction of the section and we believe that this Court would require a definite statement of this intent in Sec. 213 (a) before it would construe the section as taxing such income and pass on to the constitutional question involved. The test of the Treasury construction is, would Section 213 (a) standing alone be thought as including the interest on municipal bonds in gross income in view of the almost universal opinion that such interest cannot be taxed under the Constitution? If not, whatever is said in paragraph (b) cannot be said to imply what is taxed by paragraph (a).

In discussing the constitutional question we will analyze the legal and popular conception of life insurance proceeds, which will, of course, be as applicable to the language employed in Sec. 213 (a) as it will to the constitutional conception of income.

II.

Life Insurance Proceeds are not "Income" within the meaning of the Sixteenth Amendment and are therefore not taxable.

As a result of *Pollock* v. *Farmers' Loan & Trust Company,* 158 U. S. 601, the Sixteenth Amendment to the Constitution was adopted in 1913. It reads as follows:

> "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration."

Its purpose was not to extend the taxing power of Congress to any new or generic field, but the "prevention of the resort to sources from which a taxed income was derived in order to cause a direct tax on the income to be a direct tax on the source itself."

Brushaber v. *Union Pacific Railway Co.,* 240 U. S.-1-19.
Peck v. *Lowe,* 247 U. S. 165-172.
Evans v. *Gore,* 253 U. S. 245-260.

The rule then by which this amendment is construed is the same as the ordinary rule of constitutional construction; namely, that the language is to be given the meaning it had at the time of the adoption of the amendment. What it meant then it continues to mean, and Congress may not, by any definition it adopts, extend the power granted to any new field not comprehended by the term "income" at the time this amendment was adopted.

Gibbons v. *Ogden,* 9 Wheat 1.
McCullough v. *Maryland,* 4 Wheat, 316.
Eisner v. *Macomber,* 252 U. S. 189.

The definition adopted by this Court of "income" in its constitutional sense is:

> "Income may be defined as the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets."

> *Gray* v. *Darlington*, 15 Wall. 63.
> *Stratton's Independence* v. *Howbert*, 231 U. S. 399-415.
> *Doyle* v. *Mitchell Bros. Co.*, 247 U. S. 179.
> *Eisner* v. *Macomber*, 252 U. S. 189-207.
> *Merchant's Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509-518.

A word as to the evolution of this definition may not be out of place. Under the earlier acts only annual income was taxed, so that a profit on the conversion of property held some years was held not taxable in *Gray* v. *Darlington*, 15 Wall 63. Where the entire income was taxed in the year it was received, whenever it accrued, it was held that there was no objection to the tax on the profit. *Doyle* v. *Mitchell Bros.*, 247 U. S. 179. This accounts for the proviso to the definition. The definition itself was evolved in *Stratton's Independence* v. *Howbert*, 231 U. S. 399-415, where this court held that the income received from a mine was taxable notwithstanding the mine was depleted to the extent of the minerals taken out in any one year, on the ground that capital and labor were required to extract the mineral and make it marketable. Therefore, profits on the sale of the ore was not

a mere exchange of capital, but the receipt of income.

This definition is further elucidated in *Eisner v. Macomber*, 252 U. S. 189, 207, where it is said:

> "Brief as it is, it indicates the characteristic and distinguishing attribute of income, essential for a correct solution of the present controversy. The Government, although basing its argument upon the definition as quoted, placed chief emphasis upon the word 'gain' which was extended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived. '*Derived-from-capital*'; '*the gain-derived-from-capital,*' etc. Here we have the essential matter; *not* a gain *accruing* to capital, not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital, however invested or employed, and *coming in*, being '*derived*'—that is, *received* or *drawn* by the recipient (the taxpayer) for his *separate* use, benefit and disposal; *that* is income derived from property. Nothing else answers the description."

Do the proceeds of life insurance policies fit into this definition? Are they the gain received from capital, a profit *derived* from capital? The government answers in the affirmative and says that the insured invests money in the form of premiums in an insurance policy—this is the capital—and from that capital the proceeds are *derived* which are profit. One would have to be steeped indeed in the modern science of accounting not to detect a false ring to this argument.

Take the ordinary policy of insurance where the husband insures his life and names his wife

the beneficiary of the policy. Invariably he pays the premiums, invests the capital. She does nothing but collect the proceeds. Is she the recipient of a gift? She has invested nothing. There has been no outlay of capital upon her part. She has gained, in the sense of having a sum of money in lieu of her husand, but the gain was *derived* neither from capital nor labor. The government's logic falls at once unless the beneficiary pays the premiums. If Robert Biddle, 2nd, had paid the premiums on the insurance policies in the present case, would the company have gained anything from the investment of capital? Obviously not. And yet the essence of the proceeds would have been the same and the government would have made no distinction, as in either case the Treasury Department held the proceeds to be taxable.

Taking issue with the government directly, we deny that premiums paid are an investment of capital from which is *derived* a gain or profit. The case at bar is a striking illustration that a fallacy lurks in such reasoning. If upon an investment of $2,126.50 a profit of $97,947.28 could be made in one year, all of the money in the country would at once be poured into the insurance companies as premiums. This, of course, is simply pointed out as a test of the reasonableness of the government's theory on the face of it.

As a matter of fact, the reason why the government's theory is wrong is that the premiums paid by any individual policy holder to an insurance company bear no relation whatever to the proceeds paid to the beneficiary, except in the aggregate. In the simplest form of insurance, a group of persons associate themselves

together for protection against loss or casualty. If it is to insure against loss of property, it is known in advance that some of the group but not all will suffer such loss. From actuarial experience, the approximate amount of that loss is known, as well as the amount of the loss for each year. From this knowledge it is simply a matter of calculating how much each person must pay into the fund, which with the interest it will earn, less deductions for losses, will cover the anticipated losses. In life insurance, the only difference is that a specified amount is fixed to be paid upon the death of any of the subscribers. Insurance becomes more complicated, of course, as new members are taken in, and annual or "level" premiums are substituted for the "single premium" (paid in advance) or the "natural premium" paid concurrently with the casualty, and the load is added for overhead, etc., and the minor adjustments which must be made to adjust the premiums to necessary reserves instead of the estimated ones based on the actuary's forecast, but in principle, it is the same as the simpler form.

> *Penn Mutual Co. v. Lederer*, 252 U. S. 531-2.
>
> *Principles of Insurance*, W. F. Gephart, Vol. I, p. 258.
>
> *Life Insurance*, Solomon S. Huebner, pp. 9, 258; Chap. XV.

As was said by Justice Bradley in *N. Y. Life Insurance Co. v. Statham*, 93 U. S. 24 (23 L. Ed. 789-791):

> "The insured parties are associates in a great scheme. This associated relation ex-

ists whether the company be mutual or not. Each is interested in the engagements of all; for out of the co-existence of many risks arises the law of average, which underlies the whole business.''

It is apparent, therefore, that the proceeds issue from the capital supplied by the group and not by the individual. But the group as a group comes out just where it started for otherwise insurance companies could not exist. The group gets back the money it put into the venture and there is no profit or no gain; it is simply a return of the capital. The individuals share that return of capital in different proportions according to their original agreement, to be paid a given sum upon the happening of some casualty. Nothing is returned to the individuals fortunate enough to escape the dreaded casualty; while the stipulated amount is paid the sufferer. And the sufferers differ in their participation of the fund, for on the single premium plan, for instance, one may be out of the use of his money for many years while the other may suffer the casualty and be reimbursed within a short time, and on the annual premium plan, few or many premiums may be paid. The same thing is true of life insurance.

From this analysis, it seems clear that the proceeds of life insurance or any other kind of insurance, do not constitute profit derived from premiums. If there is any profit at all on the premiums, it is the interest which the insurance company is able to earn on the premiums, which is added to the reserve against the policy. That, of course, would be an entirely different sum

than the proceeds of the policy paid upon death or any other contingency, and would vary according to the length of time premiums had been paid in. *Cf. Penn Mutual Co.* v. *Lederer*, 252 U. S. 531-2 and cases cited. And in the case of annual premiums, the point at which a given individual of longevity passed the point where such interest becomes diminished because of earlier casualties would be of such nicety as to escape computation.

In testing the accuracy of the government's theory, we see no difference between life insurance and casualty, fire or marine insurance. In each form of insurance, premiums are paid, and if the government is correct, the proceeds issue from the premiums. And yet we venture to say that the government would not assert that insurance recovered for the loss of a ship would be income. But there is no distinction so far as the relationship between premiums and proceeds goes, and we therefore confidently say that the proceeds of insurance policies do not constitute gain or profit *derived* from the premiums as capital investment. The proceeds are *derived* from the *entire* capital supplied by the group; what the policy holder gets is compensation for a loss. And therefore, such proceeds are not contemplated within the definition of income as adopted by this court.

Our position is that the true essence or nature of insurance proceeds is indemnity for a loss sustained, and is not profit or gain in any sense. This is illustrated by the doctrine of insurable interest. Without insurable interest, the insurance contract is against public policy and cannot

be enforced. In marine and casualty insurance of all descriptions, the insurable interest must be a pecuniary interest in the property insured, in order to support the policy; and this in turn means that the contract is one merely of indemnity for the thing lost. In *The Phoenix Mutual Life Insurance Co.* v. *Bailey*, 13 Wall. (80 U. S.) 616-623, it is said:

> "Marine and fire policies are contracts of indemnity, by which the claim of the insured is commensurate with the damages he sustained by the loss of, or injury to, the property insured."

After wagering contracts were forbidden by statute, the courts came to look on insurable interest wholly as a pecuniary interest, but the subsequent development of life insurance brought a new problem, which caused an expansion of the conception of insurable interest because individuals often had no pecuniary interest in the assured as such, but were bound to him solely by consanguinity or affection. The doctrine as expended is described in *Connecticut Mutual Life Ins. Co.* v. *Schaeffer*, 94 U. S. 457-463:

> "It will be proper, in the first place, to ascertain what is an insurable interest. It is generally agreed that mere wager policies, that is, policies in which the insured party has no interest whatever in the matter insured, but only an interest in its loss or destruction, are void, as against public policy. This was the law of England prior to the Revolution of 1688. But after that period, a course of decisions grew up sustaining wager policies. The Legislature finally interposed, and prohibited such insurance; first, with regard to marine risks, by Statute of 19 Geo. II., ch. 37; and next, with

regard to lives, by the Statute of 14 Geo. III., ch. 48. In this country, statutes to the same effect have been passed in some of the States; but where they have not been, in most cases either the English statutes have been considered as operative, or the older common law has been followed. But precisely what interest is necessary, in order to take a policy out of the category of mere wager, has been the subject of much discussion. In marine and fire insurance the difficulty is not so great, because there insurance is considered as strictly an indemnity. But in life insurance the loss can seldom be measured by pecuniary values. Still, an interest of some sort in the insured life must exist. A man cannot take out insurance on the life of a total stranger, nor on that of one who is not so connected with him as to make the continuance of the life a matter of some real interest to him."

But regardless of the fact that the interest may be one of consanguinity or affection, nevertheless, the contract is one of indemnity in its essence and the proceeds received are indemnity. This is pointed out in *Central Bank of Washington v. Hume*, 128 U. S. 195:

"Marine and fire insurance is considered as strictly an indemnity; but while this is not so as to life insurance, which is simply a contract, *so far as the company is concerned*, to pay a certain sum of money upon the occurrence of an event which is sure at some time to happen, in consideration of the payment of the premiums as stipulated, *nevertheless the contract is also a contract of indemnity*." (Italics ours.)

The dual character of life insurance policies is again pointed out in *The Phoenix Mutual Life*

Insurance Co. v. *Bailey,* 13 Wall 616, where it is said that the "contract of life insurance is not necessarily one merely of indemnity for a pecuniary loss" but the policy is valid if it appears "that the beneficiary had an interest, whether pecuniary or arising from dependence or natural affection, in the life of the person insured."

We can here part company with ordinary life insurance where the insurable interest is consanguinity or affection, for a corporation beneficiary of the proceeds of a life insurance policy paid upon the death of the officer must necessarily have a pecuniary interest—else the policy would be void. But before doing so, it can be pointed out that from the standpoint of the beneficiary, the loss is none the less real because of the fact that a human life is difficult of estimation. To the average widow, the proceeds come as an indemnity and a very inadequate one for the loss of the husband. The proceeds constitute a fund, in popular conception at least, which takes the place in a small measure of the earning capacity of the husband. And the cases where the proceeds would be regarded as a clear gain are so few as to make them inconsequential in viewing the whole field. Congress may have had this motion in mind, however, in exempting proceeds paid to *individual* beneficiary, meaning thereby, *that not even in the case of individual beneficiaries* should the proceeds be included in gross income.

But whatever is the fate of proceeds received by widows and orphans, shocking though it may be to conceive them income, it is clear upon analysis that a life insurance policy upon the

life of a corporate officer, the corporation being the beneficiary, *must be a contract of indemnity.* Insurance on the life of a corporate officer was sustained on earlier decisions holding that a creditor had an insurable interest in the life of his debtor to the extent of the debt and that the contract was one of indemnity. These cases are reviewed in *Crotty* v. *Union Mutual Life Ins. Co.*, 144 U. S. 621, where Mr. Justice Brewer said:

> "Without noticing other questions discussed by counsel, it is sufficient to consider that of plaintiff's interest in the policy. It is the settled law of this court that a claimant under a life insurance policy must have an insurable interest in the life of the insured. Wagering contracts in insurance have been repeatedly denounced. *Cammack* v. *Lewis*, 82 U. S. 15, Wall, 643 (21:244), in which a policy of $3,000, taken out to secure a debt of $70, was declared 'a sheer wagering policy.' *Connecticut Mut. L. Ins. Co.* v. *Schaefer*, 94 U. S. 457, 461 (24:251, 253) in which it was said: 'In cases where the insurance is effected merely by way of indemnity, as where a creditor insures the life of his debtor, for the purpose of securing his debt, the amount of insurable interest is the amount of the debt.' *Warnock* v. *Davis*, 104 U. S. 775 (26:924).
>
> * * * *
>
> If a policy of insurance be taken out by a debtor on his own life, naming a creditor as beneficiary, or with a subsequent assignment to a creditor, the general doctrine is that on payment of the debt the creditor loses all interest therein, and the policy becomes one for the benefit of the insured and collectible by his executors or administrators. In 2 May, *Ins.* (3d ed.) 459a, the author says: 'A creditor's claim upon the proceeds of in-

> surance intended to secure the debt should go no further than indemnity, and all beyond the debt, premiums and expenses, should go to the debtor and his representatives, or remain with the company, according as the insurance is upon life or on property.' *Central Bank of Washington* v. *Hume*, 128 U. S. 195, 205 (32:370, 375)."

The courts have accordingly sustained such policies and have held that there is a real and pecuniary interest which the corporation has in the life of an officer, just as much of an interest as it has in any physical asset, and the policy is sustainable on the ground that it is an indemnity against the loss of that asset, intangible though it may be.

A case illustrating the transition from the debtor-creditor policy to the officer-corporation policy, is *Mechanics National Bank* v. *Comins*, 72 N. H. 12, 55 Atl. 191, where it is said:

> "It is hardly necessary to say that the success of a corporate enterprise may be so interwoven with the personality of its manager that its stock is taken, and money is loaned to carry it on, as much in reliance upon that personality as upon the intrinsic merit of the enterprise; and no good reason appears why a stockholder or creditor, the value of whose investment may be reasonably said to depend upon the life or health of the man at the helm, should not have an insurable interest in his life, the same as one who invests money in a partnership, relying upon the skill or experience of his copartner, has an insurable interest in the life of the latter, or one who equips a mining expedition has an insurable interest in the life of him to whom its management is committed. The

creditor or stockholder, under such circumstances, would seem to have that 'reasonable expectation of pecuniary benefit or profit from the continuance of another's life' which is held sufficient to constitute an insurable interest. In such case 'the essential thing * * * that the policy should be obtained in good faith, and not for the purpose of speculating upon the hazards of life' would appear to be present."

The leading case on the subject, which also further illustrates that the proceeds are compensation for a loss, is *Mutual Life Insurance Co. of New York v. Board, Armstrong and Company*, 115 Va. 836, 80 S. E. 565. The court there said:

"We are further of the opinion that this contract of insurance effected by the plaintiff was not an *ultra vires* act on its part and that the 'loss of service in the event of death' as stated in the policy, was a sufficient interest to maintain the policy in favor of the beneficiary * * * The deceased was the president and manager of the corporation, and had been since its organization. His relation to and knowledge of the financial and manufacturing interests of the plaintiff was such that his death could not fail to result in serious and substantial loss to its creditors and all others interested in its prosperity. Although it is well known that the leading insurance companies of the country solicit and carry the class of insurance herein involved, we have been unable to find any decision directly in point. The principles, however, announced by the decision and stated by the text writers we think clearly show that the plaintiff had an insurable interest in the life of B. F. Board, its president and general manager."

This is also the law of Pennsylvania: *U. S. Life Ins. Co. of Pa.* v. *Brown*, 270 Pa. 270, 113 Atl. 446:

> "The question of insurable interest of the employer in the life of the employee, or of the corporation in the life of its officers, though not the subject of discussion in Pennsylvania, has been considered in other jurisdictions where it is held that there is no implied interest in the life of such persons justifying the issuance of a policy for the benefit of the employer. (Citing *Victor* v. *Louisa Cotton Mills*, 148 N. C. 107; 61 S. E. 648.)
>
> To sustain a contract of this character, it must further appear that there is a real concern in the life of the party named, whose death would be the cause of *substantial loss* to those who are named as beneficiaries. This does not follow the cessation of ordinary service, but arises where the success of the business is dependent on the continued life of the employee." (Italics ours.)

These cases show conclusively that except for the monetary interest which the corporation has in the life of an officer, the contract of insurance would be illegal and void as against public policy. If that is true, the corporation suffers a loss upon the death of the officer and the insurance proceeds are nothing more than indemnity or compensation for that loss. This takes the proceeds out of the conception of "income" and places them in the category of a return of capital. If a man receives insurance for the value of a house destroyed by fire, he has gained nothing nor has he profited; he has received the equivalent in value of the thing he lost as compensation for

the loss and he is no richer than he was before. He has not received income. And the same thing is true where a corporation loses the service of an officer by death. The corporation has lost a valuable asset, an income-producing factor, and if it has provided against the possibility of that loss by insurance, the proceeds represent the loss and are not income. The proceeds become the income-producing factor.

It seems to us that the government becomes confused in its attempt to determine what is income and what is not income by reference to so-called accounting principles. One of the reasons for the complexity of income tax regulations is the attempt of the Treasury to squeeze the law into the system of balances idealized by accountants. The attempt is to fit the law to accounting, rather than accounting to the law.

The government seeks to argue that life insurance proceeds are not compensation for a loss on the ground that the officer could not be set up on the books as an asset. But if we call things by their right names instead of by the so-called technical terms of accountants, the personality and value of officers *are* set up on the books of most corporations. Only the account is called *good will*. Good will is supposed to be made up of a varied group of so-called intangibles, such as trade names, etc., but essentially it represents the public confidence in the officers and executives of the corporation, and is therefore an income producing factor in the business. If an efficient officer dies, that good will shrinks because the earning capacity of the corporation is diminished. Good will is

recognized by the Treasury Department and its value is determined by capitalizing the earnings over and above a fixed percentage on the physical assets and obsolescence of good will is in some cases permitted. There is no reason why the value of an officer cannot be estimated and carried on the books under its name as well as under the term "good will." If the officer dies, he is wiped off the slate as an asset and the insurance proceeds go to physical capital, and the company's balance sheet theoretically remains the same.

We do not say that accounts are kept in that manner, but the fact that they are not has no bearing on the question of whether or not the officer is a valuable asset so that his death may not be compensated for without the compensation being income. Carrying an officer on the books as an asset would seem no more absurd to a bookkeeper of fifty years ago than many of the other assets he would find on a modern balance sheet. Accounting as a "science" was born with the present day income tax laws and its treatment of accounts lacks any persuasive value for the reason that facts are too often concealed beneath sugar-coated nomenclature, and the basic principles to be deducted from a given state of facts is lost sight of in the desire to fit every concept into a perfect system. Lawyers long ago learned that systems must be altered to fit facts.

For instance the government argues that a loss could not be claimed because of the death of an officer. We might go further and state that so far as we know, the loss of a physical asset, so

far as the Constitution is concerned could not be claimed as a deduction from *income.* This has never been decided because Congress has always provided for the deduction of losses from current *income.* The point is that whether losses can or cannot be deducted, *compensation* received for a *loss* is not income. The thing that can be taxed under the constitutional grant is *income* but it must *be* income to be subject to the tax. If there is simply the substitution of one thing of value for another of equal value, there *is* no income.

Having shown that the proceeds of insurance are compensation for a loss, and not income derived from capital, there remains only one objection raised by the government to be answered and that is: Can the life of an officer be valued so that the extent of the loss can be calculated? This objection offers no more difficulty than the valuation of anything else. What is the value of a piece of machinery or a share of stock? The value is simply and purely a matter of judgment and estimation. If the machinery or stock has a "market" value, the judgment of the community interested in the buying and selling of such commodities is taken as fixing the value. If there is no market value, the earning capacity of the asset over a period of years is capitalized and its "value" approximated. If that cannot be done, experts are called in and give their opinions and finally someone exercises his judgment and gives his opinion as to the value and if his judgment is final, the value is fixed.

If a piece of machinery is being insured, its value is fixed in that way. If the machinery is

destroyed, that value is returned to the owner. And at this point to meet another observation of the government, the amount returned is not the income which the machine would have earned over a period of years, paid all in one year, and therefore taxable as income, but is the substitution of an equivalent of value as capital, from which income in the future will be derived, either from a new machine purchased with the money or the use of the money as capital in any way.

We see no reason why the value of an officer of a corporation cannot be arrived at just as well as anything else can be valued. It is true that being a part of an organization his earning capacity may be interwoven with that of the other members of the organization, but his value can be approximated just as well as the value of a machine performing one operation in a series of processes.

In fact, the valuation placed on the life of an officer is likely to be a conservative estimate because the company must pay premiums commensurate with the value placed on the man, and in a case like the present, where the company faces a long period of paying such premiums based on the likelihood of the officer living for a long time, the self-interest of the corporation would be persuasive of a reasonable estimate being placed on the officer's life. In the present case, Biddle was a healthy and vigorous young man of thirty-seven at the time he was insured and except for the occurrence of the influenza epidemic in the following year, would have been likely to live many years according to the ordinary expectancy of life. The interest of the company

then in conserving its resources is a good indication of the fact that Biddle's value as an asset was arrived at with care. The government has not undertaken to refute the fact that he was as valuable to the company as $100,000 of money capital. A valuation of this kind is stripped of all sentimentality and stands for what the man is worth to the company as an income-producing factor and has no reference to the esteem and affection with which his friends and family regard him. To the company he had the same kind of value as a machine or a sum of money; to his family and friends he was priceless, of course, because of attributes which bore no relation to his ability to earn income for the company, or in other words, his value as a capital asset. He had been identified with the company for years and for all that is known, expected to remain with the company; he was its president, and the leading personality of the organization and his value was as easy of estimation as any other value.

We therefore reaffirm that this company made no profit on premiums, that what it received in life insurance proceeds was compensation for a loss and not income and that the value of that loss was and could be estimated. So that these insurance proceeds do not answer the constitutional definition of income.

Besides the definition of income which this court has evolved, there is another test of whether or not a given thing is income. First, what was the meaning of income at the time of the adoption of this amendment? It has been shown that Congress never undertook to tax the

proceeds of life insurance prior to the time of the adoption of the Sixteenth Amendment; and by a Treasury construction, long acquiesced in by Congress, life insurance proceeds were not considered as taxable income. That being the known state of the law and its construction when Congress proposed the amendment and the states ratified it, the meaning of the word "income" in the Constitutional Amendment must be construed as not including the proceeds of insurance.

> *Gibbons* v. *Ogden*, 9 Wheat 1.
> *Eisner* v. *Macomber*, 252 U. S. 189.

Furthermore, the meaning which words have when used in the Constitution is not confined to technical definition, but the popular conception of such words must be taken into consideration. In *Merchants' Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509-519, Mr. Justice Clarke said:

> "In determining the definition of the word 'income' thus arrived at, this Court has consistently refused to enter into the refinements of lexicographers or economists, and has approved, in the definitions quoted, what it believed to be the *commonly understood* meaning of the term *which must have been in the minds of the people* when they adopted the Sixteenth Amendment to the Constitution." (Italics ours.)

Considering that to hold that the proceeds of a life insurance policy paid to a corporation amount to income, is to hold also that the proceeds of all life insurance policies are income in the constitutional sense, and perhaps further

still, that the proceeds of fire, marine, and casualty insurance, are income, we firmly believe that such a conception was far from the "commonly understood" meaning of the word income at the time of the adoption of the Sixteenth Amendment. To carry this point, we are perhaps reduced to the necessity of resorting to *argumentem ad hominem* but it seems to us clear that the average citizen did not look upon the payment of premiums to an insurance company as the investment of capital; rather, he looked upon them as an expense. He did not take out insurance on his life to provide a profit for his wife; what he wanted to do was to provide as large a fund as possible to sustain her and that was the wife's idea if she insured her husband. So far as he had any accurate conception of capital and income, he wanted to provide something in the nature of capital to take his place at his death. Insurance agents approached only the most gullible with the assertion that insurance was an "investment" because it could be demonstrated that money would earn more in other fields. Insurance agents soon came to "sell protection" and to support their puffing with the thought that the prospect would not miss the premiums whereas he would not set aside any savings as a fund for the protection of his dependents. In fact, insurance would never have succeeded on the basis of offering an investment in the form of profits. It was the constantly recurring example of a widow being supplied with a fund upon the death of her husband with which to sustain herself and to ward off catastrophe which taught men the

value of life insurance. The whole thought was and is that a capital fund is put at the disposal of the beneficiary. And the attitude of the rich more than that of the poor clinches the point. A man of means took out insurance to a point which would insure a safe amount of capital for his wife and dependents and with that he stopped. The remainder of his fortune he put in investments. Insurance was protection; investments which might produce income either to himself or heirs was a risk for the very reason that he was seeking income. When men invest money, they are looking for a return of income to themselves; when they take out insurance, they seek to provide a fund for the use of a beneficiary to whom they are bound by consanguinity, affection or affinity.

And what is said as to insurance taken out because of natural affection applies *a fortiori* to insurance taken out as a protection against the death of an officer of a corporation, where a monetary loss will ensue, or in the case of marine, fire or casualty insurance, where the loss of a physical asset must be compensated for.

We therefore say confidently that the proceeds of life insurance were not thought of as income by the people generally at the time of the adoption of the Sixteenth Amendment. And we are confident that corporations would not have paid out such proceeds as dividends on the theory that the corporation had made extraordinary profits, but would have preserved them as capital. The notion of such proceeds being income was not in the people's minds.

CONCLUSION.

In concluding, it must not be lost sight of that in this case the Government exacted as a tax approximately 86% of the life insurance proceeds which the company received—$84,737.95 tax on the proceeds of $97,947.28. This, of course, included a penalty of $4,468.50 which was assessed for not reporting the proceeds as taxable income, notwithstanding the company notified the Government of the receipt of these proceeds by a notation attached to its return.

The exaction of such a tax is incompatible with any notion of the usefulness and purposes of life insurance. The very size of the tax argues better than words that either the Treasury Department is wrong in its construction of the act, or, if it is right, that the act is unconstitutional so far as it attempts to tax such proceeds as income.

Considering, too, that if Robert Biddle, 2nd, had died after the passage of this act, and had paid the premiums on these policies (Reg. 63, Art. 27, 29, 30), that the proceeds would have been taxed, in addition to the income tax, an estate tax, the unconstitutionality of this tax becomes even more apparent. Double taxation is always to be avoided, and such a tax would approach dangerously near confiscation. *Brushaber v. Union Pacific Railroad Company*, 240 U. S. 1. The test of Constitutionality is what may be done and not what is done under a given act. *Moreland v. U. S.*, 258 U. S. 433-441.

Furthermore, to say that life insurance proceeds are part of the assets of a decedent's estate passing at his death and are at the same time "income" to the beneficiary (although

Congress itself has exempted the value of any devise, bequest or gift from income) is to attain the zenith of inconsistency.

We respectfully submit that life insurance proceeds are not income to the beneficiary, because they are neither taxed by the Revenue Act of 1918, nor are they income *derived* from capital; they are nothing more than an indemnity for a loss and cannot be taxed constitutionally.

Respectfully submitted,

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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1923.

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No. 447.

THE UNITED STATES, Appellant,

vs.

THE SUPPLEE-BIDDLE HARDWARE COMPANY.

APPEAL FROM THE COURT OF CLAIMS.

APPENDIX TO APPELLEE'S BRIEF.

A. MITCHELL PALMER,
Attorney for Appellee.

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APPENDIX.

Treasury Rulings, Regulations and Pertinent Parts of Acts Referred to in Appellant's Brief and Appellee's Brief.

I.

Ruling Under Act of 1867.

Ruling on Act of March 2, 1867, 14 Stats. 471, 487 (see appellee's brief, page 15).

Internal Revenue Record (N. Y.); issue of April 6, 1867, Volume V, No. 14, Whole No. 118, page 109.

Instructions, Income, Gifts of Money.

Gifts of money, when clearly not in the nature of payment for services rendered, or other valuable consideration, are not liable to taxation as income. Amounts received on life insurance policies and damages recovered in actions of tort are exempt from income tax.

II.

Act of 1913.

Section B. (1) Act of October 3, 1913, 38 Stats. 166, 181, c. 16.

B. (1) That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income derived from salaries, wages, or compensation, or personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any lawful business carried on for gain or profit, or gains or profits, and income derived from any source whatever including the income from but not the value of property acquired by gift, bequest, devise, or descent:

B. (2) Provided, That the proceeds of life insurance policies paid upon the death of the person insured

B. (3) or payments made by or credited to the insured, on life insurance, endowment, or annuity contracts, upon the return thereof to the insured at the maturity of the term mentioned in the contract, or upon surrender of contract, shall not be included as income.

* * * * * * *

G. (*a*) (1) That the normal tax hereinbefore imposed upon individuals likewise shall be levied, assessed, and paid annually upon the entire net income arising or accruing from all sources during the preceding calendar year to every corporation, joint-stock company or association, and every insurance company, organized in the United States, no matter how created or organized, not including partnerships; but if organized, authorized, or existing under the laws of any foreign country, then upon the amount of net income accruing from business transacted and capital invested within the United States during such year.

Treasury Decision 2090, *December* 14, 1914.

PART I.

Rulings in Relation to Personal Income Tax

* * * * * * *

Insurance Premium.—* * * Premiums paid on life insurance by the insured do not constitute allowable deductions under the income-tax law.

Premiums paid on life insurance taken out by a partnership upon the lives of individual members of such partnership constitute allowable deductions in ascertaining the net earnings of the partnership. However, when such policies

mature, or upon the death of the insured partner, the amount received as life insurance should be included in the gross income of the partnership.

* * * * * * *

Part II.

Rulings in Relation to Corporation Income Tax.

Life Insurance in Favor of Corporations.—In cases wherein corporations pay premiums on insurance policies insuring, in favor of the corporations, the lives of officers or others, such premiums may be allowably deducted from the gross income of the corporations paying the same.

In all such cases the proceeds of the policies when paid at maturity or upon death of the insured shall be returned by the corporation as income for the year in which such proceeds were received.

Treasury Decision 2519.

(Vol. 19, page 150.)

Treasury Department,
Office of Commissioner of Internal Revenue.
Washington, D. C., *August* 30, 1917.

To collectors of internal revenue:

T. D. 2090, in so far as it authorizes corporations to deduct from gross income the annual premiums paid on policies insuring the lives of officers or employees in favor of such corporations, is hereby modified to the extent that instead of the corporations carrying such insurance being permitted to deduct from gross income of

the year in which paid the amount of the annual premium payments, they will hereafter be permitted to deduct from the gross proceeds, when received, of any policies of which the corporations are the beneficiaries the entire amount of the premiums paid during the term of the policies, less any premium payments which, under the former ruling, have been deducted from gross income in any return of annual net income, and the net proceeds of the policies thus ascertained will be returned as taxable income of the year in which received.

W. H. OSBORN,
Commissioner of Internal Revenue.

Approved:

W. G. McADOO,
Secretary of the Treasury.

* * * * * * *

Act of September 8, 1916.

Estate Tax Provisions, c. 463, § 202.

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated:

(*a*) To the extent of the interest therein of the decedent at the time of his death which after his death is subject to the payment of the charges against his estate and the expenses of its administration and is subject to distribution as part of his estate.

* * * * * * *

Regulations 37, *Issued October* 10, 1916.

Art. IV. The gross estate of a decedent, as defined in section 202, includes:

(1) The entire estate of every kind, real, personal, and mixed, tangible and intangible property, coming into the hands of executors or administrators, or such as would legally come into their charge if executors or administrators were appointed, and which property would be subject to charges against the estate, expenses of administration, and distribution to the heirs or legatees. This would include insurance, not payable directly to a beneficiary named in the insurance contract but passing as a part of the administered estate. It would include also the good will of claimant's business, if such good will possessed an actual monetary value. It includes, of course, real estate passing directly to heirs without the intervention of administrators.

* * * * * * *

Regulations 33, Issued January 2, 1918.

Art. 29, §196—Proceeds of life insurance policies payable to the estate of a decedent, when received by an executor or administrator, are, in the amount by which such proceeds exceed the premium or premiums paid by the decedent, income of the estate to be accounted for by the executor or administrator under the provisions of section 2 (*b*), act of September 8, 1916. This return is to be made on income-tax Form 1040 or 1040A.

* * * * * * *

Regulations 33, Art. 39, §196, as Amended by Treasury Decision 3190, July 1, 1921.

Reg. 33 (Rev.), Par. 196. Proceeds of life insurance policies payable to the estate of a decedent are not to be accounted for as income of the estate by the executor or ad-

ministrator under the provisions of section 2 (*b*), Act of September 8, 1916.

* * * * * * *

Reg. 33 (Rev.), Art. 236. Life insurance premiums not deductible.—Section 32 of the Act of September 8, 1916, specifically provides that premiums paid by corporations for insurance covering the lives of officers, employees, or those financially interested in the trade or business of such corporations, shall not be deducted from the gross income of the corporations paying the same. This provision is held to apply to all forms of life insurance, the premiums upon which the corporations may pay, whether or not the corporations are the beneficiaries of the insurance policies upon the death of the insured, and all rules and regulations in conflict with this article are hereby revoked.

Regulations Under 1918 *Act.*

Reg. 45, Art. 294.—Premiums paid by a taxpayer on an insurance policy on the life of an officer, employee, or other individual financially interested in the taxpayer's business, for the purpose of protecting the taxpayer from loss in the event of the death of the officer or employee insured are not deductible from the taxpayer's gross income. If, however, the taxpayer is in no sense a beneficiary under such a policy, except as he may derive benefit from the increased efficiency of the officer or employee, premiums so paid are allowable deductions. See articles 33 and 105-108. In either case the proceeds of such policies paid upon the death of the insured may be excluded from gross income if the beneficiary is an individual, but must be included in gross income if

the beneficiary is a corporation. See Section 213 (*b*) (1) and articles 72 and 541.

Reg. 45, Art. 541.—The gross income of a corporation for the purpose of the tax in general includes and excludes the same things as the gross income of an individual. It embraces not only the operating revenues, but also gains, profits, and income from all other sources, such as rentals, royalties, interest, dividends from stock in other corporations, and profits from the sale of capital assets. The proceeds of life insurance policies paid upon the death of the insured to a corporation beneficiary, less any premiums paid by the corporation and not deducted from gross income, are to be included in its gross income. See sections 213 and 215 of the statute and articles 31-88 and 294. But in the case of life and mutual marine insurance companies and of foreign corporations there are special provisions. See articles 548-550.

* * * * * * *

Act of 1918, *Estate Tax Regulations* 37

Art. 32. Taxable insurance.—The statute provides for the inclusion in the gross estate of certain forms of insurance taken out by the decedent upon his own life. Two kinds of insurance are taxable: (*a*) all insurance payable to the estate; (*b*) insurance payable to individual beneficiaries to the extent that it exceeds $40,000. The term "insurance" refers to life insurance of every description, including death benefits paid by fraternal beneficial societies, operating under the lodge system. Insurance is deemed to be taken out by the decedent in all cases where he pays the premiums, either directly or indirectely, whether or not he makes the application. On the other hand, the

insurance should not be included in the gross estate, even though the application is made by the decedent, where the premiums are actually paid by some other person or corporation, and not out of funds belonging to, or advanced by, the decedent. Where the decedent takes out insurance in favor of another person or corporation, as collateral security for a loan or other accommodation, and the decedent, either directly or indirectly, pays the premiums thereon, the insurance must be considered in determining whether there is an excess over $40,000. Where the decedent assigns a policy, and retains no interest therein, and thereafter pays no part of the premiums, the insurance will not be considered in determining whether there is such a taxable excess.

Art. 33. Insurance in favor of the estate.—The provision requiring the inclusion in the gross estate of all insurance receivable by the executor, without any deduction, applies to policies made payable to the decedent's estate or his executor or administrator, and all insurance, regardless of the manner of execution, which is in fact receivable by the estate, or which must be used to pay charges against the estate or the expenses of administration. This provision includes insurance taken out to provide funds to meet the estate tax, state inheritance taxes, or any other legal charge upon the estate. The manner in which the policy is drawn is immaterial so long as there is an obligation, legally binding upon the beneficiary, to use the proceeds in payment of the charge.

Art. 34. Insurance receivable by other beneficiaries.—The estate is entitled to only one exemption of $40,000 upon insurance payable to beneficiaries other than the executor. For example, if the decedent left life insurance payable to three persons in amounts of $10,000, $40,000, and $50,000 (total

$100,000), the amount of $60,000 should be returned for taxation, which is the excess of the sum of the three policies over the exempted amount. The word "beneficiary," as used in reference to the $40,000 exemption, means a person entitled to the actual enjoyment of the insurance money.

Art. 35. Effective date of insurance provisions.—Insurance receivable by the executor must be included in the gross estate of all decedents who died after September 8, 1916. Insurance payable to beneficiaries other than the executor, however, need not be included in the gross estate of decedents who died before February 25, 1919, the effective date of the Revenue Act of 1918, unless the insurance was originally payable to the estate, and was transferred by the decedent to specific beneficiaries in contemplation of death.

Art. 36. Valuation of insurance.—The amount to be returned in the case of any policy is the amount actually receivable by the executor or beneficiary. In cases where the proceeds of a policy are made payable to the beneficiary in the form of an annuity for life or for a term of years, the present worth of the annuity at the time of death should be included in the gross estate. For the method of computing the value of such an annuity, see Article 20. Where the insurance contract gives an option to receive a fixed sum of money in lieu of an annuity, this sum, if accepted, represents the value of the insurance for the purpose of the tax. If such sum is not accepted the value of the annuity is to be included in the gross estate. Where there is more than one option, and nine of them is convertible, the value of the insurance should be determined in accordance with the option actually exercised.

(Reg. 62, Art. 27, 28, 29, 30 and 31 under the Act of 1921,

are substantially the same as the above, with slight modifications in wording.)

This case is before the Committee on appeal from the decision of the Income Tax Unit holding that the M Company of which A was the sole owner of the stock, is liable for income and excess profits taxes on the proceeds of a life insurance policy received in 1918.

Ruling of Committee on Appeals and Review
Ruling 50-20-1345
I.R.B. 335
3 Cumulative Bulletin
p. 244
(1920)

The facts appear to be that A, now deceased, was the sole owner of the capital stock of the M Company, a holding company which was organized to hold title to certain property belonging to A, and that during his lifetime he took out a life insurance policy on his life and made it payable to the M Company upon his death, but reserved the right to change at any time the beneficiary named in the policy. He paid all the premiums on the policy, the corporation had no investment in said policy, and upon his death the proceeds thereof were paid to the company.

The corporation contends that the proceeds of the policy in question do not constitute taxable income in the hands of the corporation, because such proceeds represent a gift to the corporation and are in no event gross income within the meaning of that term as used in section 213 (*a*) of the Revenue Act of 1918.

The only question presented in this appeal may be stated as follows: Do the proceeds of an insurance policy paid under the circumstances stated above upon the death of the insured to a corporate beneficiary constitute taxable income to the recipient under the provisions of the Revenue Act of 1918? This being purely a question of law, it was submitted to and passed upon by the Solicitor.

In order to pass upon the case it is necessary to examine the provisions of law on the subject.

Section 233 (*a*) of the Revenue Act of 1918 provides:

That in the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in section 213, * * * with certain exceptions not here material.

Section 213 of the act provides:

That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—

(*a*) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever * * * but

(*b*) Does not include the following items, which shall be exempt from taxation under this title:

(1) The proceeds of life insurance policies paid upon the death of the insured to individual beneficiaries or to the estate of the insured:

* * * * * * *

(3) The value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included in gross income).

Article 294 of Regulations 45 as amended by T. D. 3019 deals with the question of premiums on business insurance and reads as follows:

Premiums paid by a taxpayer on an insurance policy on the life of an officer, employee, or other individual financially interested in the taxpayer's business, for the purpose of protecting the taxpayer from loss in the event of the death of the officer or employee insured are not deductible from the taxpayer's gross income. If, however, the taxpayer is in no sense a beneficiary under such a policy, except as he may derive benefit from the increased efficiency of the officer or employee, premiums so paid are allowable deductions. See articles 33 and 105 to 108. In either case the proceeds of such policies paid upon the death of the insured may be excluded from gross income if the beneficiary is an individual, but must be included in gross income if the beneficiary is a corporation. (See section 213 (*b*) 1 and articles 72 and 541.

Section 213 (*a*) defines gross income as including certain specified items and the "gains or profits and income derived from any source whatever." It was then provided in section 213 (*b*) 1 that the gross income should not include the proceeds of a life insurance policy paid to individual beneficiaries. This provision of law shows by implication that Congress considered that "gross income" would, without the specific exclusion of the proceeds of life insurance policies paid to individual beneficiaries, or to the estate of the insured, comprehend the proceeds of all life insurance policies.

From the foregoing it is reasonable to assume that Congress, by excluding from gross income the proceeds of life

insurance policies payable to an individual beneficiary or the estate of the insured, intended that such proceeds should be included in gross income when received by beneficiaries other than individuals or the estate of the insured. This view is supported by the legislative history of the act. Section 213 (*b*) 1 is identically the same as it appeared in the bill as drafted in the House. The Senate attempted to amend this section and it is stated in the Senate report on the Revenue Bill of 1918 (Report No. 617, 65th Congress, 3rd Session, page 6), that:

> The proceeds of life insurance policies paid upon the death of the insured are, under the House bill, exempt from taxation only when paid to individual beneficiaries, or to the estate of the insured. This limitation has been removed so as to place all beneficiaries, individual, corporate or otherwise, on the same footing.

The Senate later receded from this position and section 213 (*b*) 1 as drafted by the House, excluding from gross income the proceeds of life insurance policies only when paid to individual beneficiaries or to the estate of the insured, became the law.

After analyzing the arguments presented in this case and in view of the foregoing provisions of law and regulations, it is the opinion of the Committee that the proceeds of life insurance policies paid upon the death of the insured to a corporate beneficiary constitute a part of the gross income of such beneficiary for the purpose of the income and profits taxes imposed by the Revenue Act of 1918. Therefore, it is recommended that the action of the Income Tax Unit be affirmed.

It is also the opinion of the Committee that the receipt of the proceeds of the life insurance policy in question by this corporation creates an abnormal condition which affects the income of the corporation for the taxable year 1918. It is thought that the receipt of this income brings this corporation clearly within the provisions of section 327 (*d*) of the Revenue Act of 1918.

It is therefore recomended that the tax in this case be computed in accordance with the provisions of section 328 of the Act.

A. MITCHELL PALMER,
Attorney for Appellee.

FREDERIC L. CLARK,
FRANK DAVIS, Jr.,
WILLIAM D. HARRIS,
Of Counsel.

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Supreme Court of the United States

OCTOBER TERM—1923.

No. 447.

17

United States of America,
Appellant (Defendant),

against

Supplee-Biddle Hardware Company,
Respondent (Plaintiff).

APPEAL FROM THE COURT OF CLAIMS

BRIEF AND PETITION
With Notice of Motion for Leave to File Brief as Amici Curiae

HENRY NECARSULMER,
MAX J. KOHLER,
Of Counsel,
as *Amici Curiae*.

ANALYTICAL INDEX.

CASES CITED.

STATUTES, REGULATIONS AND MISCELLANEOUS BOOKS.

Supreme Court of the United States

OCTOBER TERM—1923.

No. 447.

UNITED STATES OF AMERICA,
Appellant (Defendant),

against

SUPPLEE-BIDDLE HARDWARE COMPANY,
Respondent (Plaintiff).

Notice of Motion for Leave to File a Brief as Amici Curiae.

You will please take notice that the undersigned, acting as counsel for Bernhard Ulmann Co., Inc., a New York corporation, interested as a claimant for refund of taxes in the questions involved in the above entitled suit, will ask leave of the Court at the opening of the Court on Monday, April 7, 1924, or as soon thereafter as counsel can be heard, to file a brief as *amici curiae* and for such other or further relief as may be proper.

New York, April 1, 1924.

HENRY NECARSULMER,
MAX J. KOHLER,
Of Counsel.

To

Hon. James M. Beck,
Solicitor General,
Department of Justice,
Washington, D. C.

Alfred A. Wheat, Esq.,
Special Assistant to the Attorney General.

Hon. A. Mitchell Palmer,
Counsel for Plaintiff (Respondent).

SUPREME COURT OF THE UNITED STATES,

OCTOBER TERM—1923.

No. 447.

UNITED STATES OF AMERICA,
Appellant (Defendant),

ainst

SUPPLEE-BIDDLE HARDWARE COMPANY,
Respondent (Plaintiff).

Petition for Leave to File Brief as Amici Curiae.

The undersigned respectfully petition this Honorable Court for leave to file accompanying brief as *amici curiae* in the above entitled suit.

You petitioners apply as counsel for the Bernhard Ulmann Co., Inc., a New York corporation, which has filed a claim for refund of $43,178.71 income and excess profits taxes assessed against said corporation under the Revenue Act of 1918 on the proceeds of two ordinary life insurance policies of $50,000.00 each, covering the life of its president and payable to the corporation.

The issues presented in the above mentioned suit include the determination of the constitutionality of the Revenue Act of 1918 in so far as it purports to impose an income tax on the proceeds of life insurance policies payable to a corporation, on the life of one of its officers.

The issues presented in said claim for refund are practically the same as in the above entitled suit.

The claim of your petitioners' client would therefore be necessarily determined by the deci-

sion of the questions involved in the above entitled suit, and counsel understand that the Internal Revenue Bureau is delaying determination of said claim pending the determination of this appeal.

The questions involved are of considerable general importance.

Notice of this application and a copy of the brief of your petitioners have been served upon the counsel for the respective parties in the above entitled suit.

All of which is respectfully submitted for the consideration and action of the Court.

New York, N. Y., April 1, 1924.

HENRY NECARSULMER,
MAX J. KOHLER,
Of Counsel.

SUPREME COURT OF THE UNITED STATES,

OCTOBER TERM—1923.

No. 447.

UNITED STATES OF AMERICA,
Appellant (Defendant),

against

SUPPLEE-BIDDLE HARDWARE COMPANY,
Respondent (Plaintiff).

BRIEF IN SUPPORT OF RESPONDENT.

This is an appeal from a judgment of the Court of Claims in favor of plaintiff in the sum of $55,138.89, representing income and excess profits taxes assessed against plaintiff on "term" life insurance policies payable to and collected by plaintiff, in the sum of $97,947.28 upon the life of its deceased president and managing head, Robert Biddle, 2nd, which policies were taken out in April, 1917, payable to plaintiff and on which it paid the premiums. Mr. Biddle was the soul and dominating head of plaintiff corporation, and his death inflicts a loss upon it far in excess of the proceeds of the policies involved. Mr. Biddle died of influenza in October, 1918, and the tax was assessed by the Internal Revenue officials under the alleged authority of Sections 213, 230 and 233 of the Revenue Act of 1918, adopted February 24th, 1919 (40 Stat., 1057), as construed by the Commissioner of Internal Revenue and plaintiff paid the tax under protest, and then instituted this suit for its refund. The Court of Claims unanimously sustained plaintiff's contention and the Government has appealed.

POINT I.

The proceeds of life insurance policies payable at the death of the insured, whether payable to corporations or individual beneficiaries, are not "income" under the Federal Constitution, and Federal statutes ought to be construed to avoid such serious constitutional question as arises from wresting the term "income" from its ordinary meaning.

(a) This Court, in the case of

> *Eisner* v. *Macomber*, 252 U. S., 189, at 205-7,

laid down a definition of the term "income" and tests which, it is submitted, require an affirmance of the decision below in favor of the taxpayer. Speaking by Mr. Justice Pitney, it said:

> "The Sixteenth Amendment was adopted, in words lucidly expressing the object to be accomplished: 'The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment, among the several States and without regard to any census or enumeration.' As repeatedly held, *this did not extend the taxing power to new subjects*, but merely removed the necessity which otherwise might exist for an apportionment among the States of taxes laid on income. Brushaber *v.* Union Pacific R. R. Co., 240 U. S., 1, 17-19; Stanton *v.* Baltic Mining Co., 240 U. S., 103, 112, *et seq.;* Peck & Co. *v.* Lowe, 247 U. S., 165, 172-173. A proper regard for its genesis, as well as its very clear language, requires also that this Amendment *shall not be extended by loose construction*, so as to repeal or modify, except as applied to income, those provisions of the Constitution that require an apportionment according to population for direct taxes upon

property, real and personal. This limitation still has an appropriate and important function, and is not to be overridden by Congress or disregarded by the courts. In order, therefore, that the clauses cited from Article I of the Constitution may have proper force and effect, save only as modified by the Amendment, and that the latter also may have proper effect, *it becomes essential to distinguish between what is and what is not 'income,' as the term is there used; and to apply the distinction, as cases arise, according to truth and substance, without regard to form.* Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution, from which alone it derives its power to legislate, and within whose limitations alone that power can be lawfully exercised. *The fundamental relation of capital to 'income' has been much discussed by economists, the former being likened to the tree or the land, the latter to the fruit or the crop; the former depicted as a reservoir supplied from springs, the latter as the outlet stream, to be measured by its flow during a period of time. For the present purpose we require only a clear definition of the term 'income,' as used in common speech, in order to determine its meaning in the Amendment;* and, having formed also a correct judgment as to the nature of a stock dividend, we shall find it easy to decide the matter at issue. After examining dictionaries in common use (Bouv. L. D.; Standard Dict.; Webster's Internat. Dict.; Century Dict.), we find little to add to the succinct definition adopted in two cases arising under the Corporation Tax Act of 1909 (*Stratton's Independence* v. *Howbert*, 231 U. S., 399, 415; *Doyle* v. *Mitchell Bros. Co.*, 247 U. S., 179, 185)—*'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets,* to which it was

applied in the Doyle case (pp. 183, 185). Brief as it is, it indicates the characteristic and distinguishing attribute of income essential for a correct solution of the present controversy. The Government, although basing its argument upon the definition as quoted, placed chief emphasis upon the word 'gain,' *which was extended to include a variety of meanings: while the significance of the next three words was either overlooked or misconceived. 'Derived - from - capital:'—the 'gain - derived-from-capital,' etc.* Here we have the essential matter; not a gain accruing to capital, not a growth or increment of value in the investment; *but a gain, a profit, something of exchangeable value proceeding from the property,* severed from the capital, however invested or employed, and coming in, being 'derived,' that is, received or drawn by the recipient (the taxpayer) for his separate use, benefit and disposal;—that is income derived from property. Nothing else answers the description."

(b) In the present case, we have no express statute, attempting directly to tax such insurance, when payable to a corporation, but, at most a mere alleged inference, arising from an exemption of such policies when payable to individuals, under the Act of February 24, 1919 (40 Stat., 1057 at 1065 and 1077, Sections 213 and 233 (a) respectively). The case is, therefore, much more like *Towne* v. *Eisner*, 245 U. S., 418, than *Eisner* v. *Macomber*, *supra*, in which latter case the Court was compelled squarely to decide the constitutional question as to stock dividends, accruing and paid, subsequent to the 16th Constitutional Amendment. Here, therefore, we are directly within the rule of

U. S. v. *Delaware & Hudson Co.*, 213 U. S., 366, 408;
U. S. v. *Jin Fuey Moy*, 245 U. S., 394, 401.

Matter of International Railway Co., 226 N. Y., 474, 482, holding that *a statute should be construed, if possible to avoid reaching a result of doubtful constitutionality.* As said concisely by Mr. Justice Holmes, speaking for the Court in the *Jin Fuey Moy* case:

> *"A statute must be construed, if fairly possible, so as to avoid not only the conclusion that it is unconstitutional, but also grave doubts upon that score."*

The leading points of inquiry under such a statute are thus indicated in *Eisner* v. *Macomber, supra*, as:

(1) Was such insurance regarded as "income" at the time of the enactment of the 16th Amendment, it being settled that the Amendment was not designed to extend the taxing power to new subjects.

(2) In answering the inquiry, regard is to be had of the difference between "capital" and "income" in the ordinary acceptation of the terms, and that the latter must "*proceed*" from the former. In that connection, the language of the Court in *Doyle* v. *Mitchell Bros. Co.*, 247 U. S., 179, 185, is very much in point:

> "Whatever difficulty there may be about a precise and scientific definition of 'income,' *it imports, as used here, something entirely abstract from principal or capital*, either as a subject of taxation or as a measure of the tax; *conveying* rather the idea of *gain or increase arising from corporate activities*. As was said in *Stratton's Independence* v. *Howbert*, 231 U. S., 399, 415, 'Income may be defined as the gain derived from capital, from labor, or from both combined. * * * *In order to determine whether there has been gain or loss and the amount of the gain, if any, we must with-*

draw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration.'"

(3) *Income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets.*

(c) Though it is proposed to consider more fully, under Point II, the construction of the paragraphs of the Income Tax Law of 1918 (adopted February 24, 1919), here involved, it will be convenient to quote the sections in question at this point, bearing in mind the fact that no prior statute or judicial decision before 1914 lends color to the claim, that the proceeds of a life insurance policy are "income," as also the fact that the elimination after "paid" of the words "individual beneficiaries or to the estate of the insured," expressly led to the abandonment of the Government's contention that life insurance policies payable upon death to corporations are income under the present Act, enacted in 1921, Sec. 213(b) (Regulations 62, Article 541, 1922).

The Revenue Act of 1918 (40 Stat., 1057, *et seq.*), devotes its Title I to "General Definitions" and Title II to "Income Tax,"—Part II thereof (Sections 210, *et seq.*, p. 1062, *et seq.*), dealing with the tax on individuals, and Part III (Sec. 230, *et seq.*, p. 1075, *et seq.*), dealing with the tax on corporations. In the section dealing with the tax on individuals, we read (p. 1065):

> "Sec. 213: That for the purpose of this title (except as otherwise provided in section 233) the term 'gross income'
>
> (a) includes gains, profits and income derived from salaries, wages and compensation

for personal service * * * *or gains or profits and income derived from any source whatever*, but

(b) Does not include the following items, which shall be exempt from taxation under this title:

(1) *The proceeds of life insurance policies paid upon the death of the insured to individual beneficiaries or to the estate of the insured;*

(2) The amount received by the insured as a return of premium or premiums paid by him under life insurance endowment or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract;

(3) The value of property acquired by gift, bequest, devise or descent (*but the income from such property shall be included in gross income*);"

In the part of this Title dealing with the Income Tax on corporations, which begins with Section 230 (p. 1075), we find, at page 1077:

"Sec. 233: That in the case of a corporation subject to the tax imposed by section 230, the term *'gross income' means the income as defined in section 213*, except that

(1) in the case of life insurance companies, there shall not be included in gross income such portion of any actual premium received from any individual policy-holder, etc. (provisions follow as to mutual marine insurance corporations, and foreign corporations)."

As regards Section 213, dealing with individuals, it will be observed, that all life insurance policies payable on the death of the insured are expressly excepted from income, barring only, possibly, policies payable to a partnership, but

such entity was expressly exempt as such from income tax under Section 218, and the Commissioner of Internal Revenue ruled that life insurance payable to it was exempt (Digest of Income Tax Rulings No. 19, April, 1919—Dec., 1921, p. 131, under Sec. 213 b., Art. 72).

Section 233 applied the same definition to corporate income as was applicable to individuals, with exceptions thereinafter expressly enumerated; and as will be further argued hereafter, it is unreasonable to suppose that a nominal limitation applicable only to individuals was *thereby* intended to be applied to corporations in a phrase adopting the former definition to the latter, and such contention is "over-literalness," and straining at the letter. The important matter to be considered is,—as pointed out hereinafter, in quoting from an able opinion by Attorney General Gregory (31 Opinions, 304), dealing with Accident Insurance under the Income Tax Laws,—that it is necessary to bring the same under the phrase

> "gains or profits and income derived from any source whatever"

to make the insurance policy proceeds here involved, taxable, as against corporations.

As further evidence that *capital,* rather than *income,* is here involved, we note:

> "Sec. 215 (p. 1069): That in *computing* net income, *no deduction shall be allowed in respect of* * * *
>
> (d) *Premiums paid on any life insurance policy covering the life of any officer* or employee or of any person *financially interested in any trade or business carried on by the taxpayer* when the taxpayer is directly or indirectly a beneficiary under such policy"

a provision evidently based on the theory that dis-

bursements incurred in connection with non-taxable items, are not to be deducted from income, and evidently intended to be applicable to corporations, too, as witness the term "officer."

(d) *The question whether life insurance is "income" was squarely raised under our Civil War Income Tax Laws, and directly answered in the negative by our administrative authorities, and such determination, uniformly followed until after the 16th Amendment was adopted, is entitled to much weight.*

On April 23rd, 1866, the Deputy Commissioner of Internal Revenue, under the Income Tax Laws then in force (Act June 30, 1864, 13 Stat., 281, *et seq.*, as amended March 3, 1865, 13 Stat., 469, and March 10, 1866, 14 Stat., 4-5),—which used the same phrase as the recent Acts above quoted as to "gains, profits or income from any other source whatever" (but without any specific reference to life insurance policies)—ruled:

> "To your inquiry of the 16th instant 'Is a sum received by A from a life insurance company upon a policy taken out by B for the benefit of A, taxable in any form under the excise tax?' I reply that by the rulings of this office, *sums of money paid by insurance companies are subject to neither legacy nor income tax.*" (3 Internal Revenue Record, 140.)

Similarly in Instructions to U. S. Assessors under date of Jan. 1, 1868, the U. S. Commissioner of Internal Revenue, under similar acts, in dealing with the deductions of premiums on insurance, wrote:

> "20°. So far as insurance monies are paid as an expense of business they are deductible from income, but *no insurance on homestead of taxpayer, nor on his life or other lives,* nor

on his rented property (if paid by tenant) *can be allowed*. Insurance paid by tenant is deductible from tenant's income as rent paid." (7 Internal Revenue Record, 59.)

Both of these rulings are summarized in Bump's "Internal Revenue Laws" (1870 ed., pp. 287, 294), and they seem to be the only recorded American rulings, pro or con, antedating the adoption of the 16th Amendment. In line with these rulings, reference is in order, on the question as to what was understood to be taxable income, to the decision in

Gray v. *Darlington*, 15 Wallace, 63 (1872),

holding that a profit realized on the sale of bonds is not taxable under the Income Tax Law, even though its authority as to taxability of the proceeds of sale or conversion of capital assets is shaken by recent cases.

It is significant, that no attempt was made to treat the proceeds of life insurance, either in statutes or rulings, as "income" until some time after the 16th Amendment was adopted, while, on the other hand, as we will presently see, such proceeds have been treated as capital, to be taxed under Inheritance Tax Laws, or declared exempt even from such acts, on grounds of public policy or long usage. The Income Tax Law of 1913 (38 Stat., 166 at 167, Sec. 2 B), while assessing a tax on various kinds of income, including finally

> "gains or profits and income derived from any source whatever, *including the income from, but not the value of property acquired by gift, bequest, devise or descent*" (continued)
>
> "Provided, that *the proceeds of life insurance policies paid upon the death of the person insured*, or payments by or credited to the insured, on life insurance endowments or annuity contracts upon the return thereof to the

insured, at the maturity of the term mentioned in the contract, or upon the surrender of contract, *shall not be included as income.*"

Under this Act, the Regulations of the Commissioner of Internal Revenue, approved by the Secretary of the Treasury, dated Jan. 5th, 1914, treated all "proceeds of life insurance policies paid upon the death of the persons insured to beneficiaries" as excludable from gross income (Regulations No. 33, Articles 5; 96 *et seq.*).

It will be observed that the alleged words of limitation "paid * * * to individual beneficiaries or to the estate of the insured" are not present there. On the other hand, *on the doctrine of associated words,* it is obvious that the *association of "life insurance" with property acquired by gift, bequest, devise or descent—in terms made not taxable itself, though the income therefrom was rendered taxable*—indicates the underlying idea in the draftsman, that capital was in each case involved, only the income from which was to be taxable, and this association of thought is carried through all the various Income Tax Laws.

> *Gegiow* v. *Uhl*, 239 U. S., 3, 10;
> *U. S.* v. *Baumgartner*, 259 F., 722, 724-5;
> *Howe* v. *U. S.*, 247 F., 292, 294 C. C. A.;
> 36 *Cyc.*, 1118.

The Act of 1916 (39 Stat., 756-758), defined income as above, and in Sec. 4 enacted the exemption of life insurance policies from "income" in a paragraph dealing with individual incomes, but did not in terms include a definition of corporate income, similar to that in the later Act of 1918, quoted. On the other hand, the Act of October 3, 1917 (40 Stat., 300-38), in Sec. 504, in terms imposed a tax of eight cents per $100, on every life

insurance policy issued, and in Sec. 1211 (40 Stat., 338), amended Sec. 32 of the Act of 1916, by providing

> "that premiums paid on life insurance policies covering the lives of officers, employees or those financially interested in any trade or business conducted by an individual, partnership, *corporation* * * * shall not be deducted in computing the net income of such individual, corporation * * * or in computing the profits of such partnership for the purpose of subdivision (e) of section 9,"

again clearly evidencing the theory that exempt assets under the Income Tax Law were involved, disbursements in connection with which should not be deductible from gross income. This view was strengthened by a new section in the Revenue Law of 1918, here directly involved (40 Stat., pp. 1097-8) (obviously treating such policies as capital), making life insurance policies payable at death, taxable under the "Estates Tax," as follows: those payable to decedent's estate absolutely, and those to other beneficiaries for the excess over $40,000, reading:

> "Sec. 402: * * * That the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated * * *
>
> (b) to the extent of the amount receivable by the executor as insurance under policies taken out by the decedent upon his own life; and to the extent of the excess over $40,000 of the amount received by all other beneficiaries as insurance under policies taken out by the decedent upon his own life."

Under the Acts of 1916 and 1917, at a time when the Government was still declining to acquiesce in the ruling as to stock dividends rendered by

this Court under the Act of 1913 in *Towne* v. *Eisner*, 245 U. S., 418, as applied to the constitutional question relative to stock dividends, earned and declared after the 16th Amendment was adopted (31 Opinions, 213), Attorney General Gregory rendered a very able opinion as to the *non-taxability of the proceeds of accident insurance policies* under the Income Tax Laws of 1916 and 1917, which is very much in point here, reported as

31 Opinions Attys. General, 304.

Almost all of his reasoning applies also to life insurance policies payable to corporations, there having been no specific provision in the acts in question as to accident insurance; and nearly all his arguments meet points relied on herein by the Government. Mr. Gregory said:

> "2. *It is evident that if the proceeds of an accident insurance policy are to be brought within the provisions of the act of September 8, 1916, as amended, it must be under the general words of subdivision (a) of Section 2, supra: 'gains or profits and income derived from any source whatever.'"*

After quoting from *Doyle* v. *Mitchell Bros. Co.*, 247 U. S., 179; *Lynch* v. *Hornby*, 247 U. S., 339; *Lynch* v. *Turrish*, 247 U. S., 221 *and Southern Pacific Co.* v. *Lowe*, 247 U. S., 330 he continued:

> "Are the proceeds of an accident insurance policy 'gains or profits and income' according to the principles thus laid down by the Supreme Court? *The proceeds of life insurance policies are expressly exempted from the act by section 4; nor does the fact that the section refers to them as 'income' seem significant. 'The value of property acquired by gift, bequests, devise, or descent' is treated in the same way, and yet the 'income' from such property is included. This seems to imply that*

the property itself is capital. As to fire, marine, and casualty insurance, paragraph (a) of section five impliedly prohibits the deduction of losses when compensated for by such insurance. Upon this point the Court of Appeals for the Sixth Circuit in *Doyle* v. *Mitchell Brothers Company* (235 Fed., 686, 688), in illustrating the principles subsequently declared to be sound by the Supreme Court in the same case, said:

"'* * If an illustration were needed to show that money received from selling capital assets cannot be "income," it would be found in *the statutory treatment of insurance money. A loss suffered during the year may be deducted from income, but not so if the loss was compensated by insurance.* Fire insurance money is clearly a substitute for the assets burned; but we find that in case of a fire loss uninsured, the loss may be deducted from income, while if it is insured, and if the insurance money is "income," the loss may not be deducted, and the insurance money must be added—*an absurdity which can be avoided only by saying that such insurance money is not income at all.* The proceeds of the sale of a building or other permanent assets are as clearly a substitute therefor as is the insurance money paid to indemnify for a building burned.'

"Assuming that this dictum is a correct construction of the act, and is not directly applicable to accident insurance as included in casualty insurance, it follows that *if the proceeds of such accident insurance are held to be 'income,' they are in a category different from the proceeds of any other kind of insurance.* In my opinion the act does not make such a distinction, because *the proceeds of an accident insurance policy are not 'gains or profits and income' as these terms are defined by the Supreme Court. Without affirming that the human body is in a technical sense the 'capital' invested in an accident policy, in a broad, natural sense the proceeds of the policy do*

but substitute, so far as they go, capital which is the source of future periodical income. They merely take the place of capital in human ability which was destroyed by the accident. They are therefore 'capital' as distinguished from 'income' receipts."

It will be observed from the above that the Attorney-General properly considered as having no real significance, the circumstances that the Act, in exempting such receipts, itself describes it as "income," and he makes the point hereinbefore suggested as here applicable, that *insurance* is analogous to "*property acquired by gift, bequest, devise, or descent,*" which the statute treats as capital, making the *income therefrom* merely taxable. His further point, here applicable, is also sound, that "insurance" on life (whether accident or life insurance) is not income, but a "*substitute*" for the "human body, taking the place of capital in human ability which was destroyed."

(e) *In fact, policies of life insurance paid upon the death of insured persons have constantly been treated by the courts as in the nature of capital, taxable under inheritance tax laws, even without specific references to such insurance in the statutes, unless—as occasionally occurs—they are regarded, on grounds of public policy or long usage, as entirely exempt from taxation, in the absence of specific provisions for their taxability.*

> *3 Internal Revenue Record,* 140 (1866; above quoted);
>
> *Tyler* v. *Treasurer,* 226 Mass., 306 (see *post.*);
>
> *Matter of Knoedler,* 140 N. Y., 377;
>
> *Matter of Voorhees,* 200 App. Div., 259;
>
> *Matter of Parsons,* 117 App. Div., 321;

In re Bullen's Estate, 143 Wis., 512, 523 (affirmed on other points in 240 U. S., 625);
Matter of Allis, 174 Wisc., 527;
Gaither v. *Miles*, 268 Fed. R., 692.

The fact that a corporation is the beneficiary is immaterial, because even a gift to a corporation has been sustained as not of the character of income, though, of course life insurance is not a gift where the corporation beneficiary pays the premiums.

U. S. v. *Oregon Washington R. & N. Co.*, 251 F., 211 (C. C. A.).

(f) *Some leading cases, dealing with the nature of life insurance policies, have gone even further than did Attorney General Gregory in the opinion cited, in describing them as in the nature of indemnity, especially when taken out in favor of a corporation, at its expense, on the life of an officer, and not merely as "substitute for human life."* The purpose is, of course, in the nature of compensation for loss, and depends upon death, and is not profit, yielded merely by a succession of premiums, regardless of the life involved. Only persons having an insurable interest can take out such insurance, and statutes regulate rates, reserves, conditions, etc. based upon average duration and probability of life, all tending to minimize the wagering element, so that the insurance companies, on the average, make a slight profit on each policy, and not the insured or the person paying the premiums. Commonly, as in "term insurance" which is directly involved here, and very largely in the case of "ordinary life," practically no return is received at all, if the policy is permitted to lapse before its maturity. Everything involved indicates that

language is stretched from the ordinary meaning, in regarding the proceeds of a life insurance policy as "income," yielded on the "premiums," regarded as capital. Said this Court in

> *Washington Central Bank* v. *Hume*, 128 U. S., 195:
>
> "*Marine and fire insurance is considered as strictly an indemnity*, but while this is not so as to life insurance, which is simply a contract, so far as the company is concerned, to pay a certain sum upon the occurrence of an event which is sure at some time to happen, in consideration of the payment of the premiums as stipulated, *nevertheless the contract is also a contract of indemnity*."

In the case in question, where an insolvent debtor paid premiums on the insurance policies involved, payable to his wife and children, though without fraudulent intent, this Court reversed the holding below, giving to creditors the premiums involved, saying:

> "The premiums form no part of the proceeds of the policies, and cannot be deducted therefrom on that ground.'

Life insurance policies payable to corporations in which the insured is active, and on which they pay the premiums, have been sustained, as far as an insurable interest is involved, but special facts must be shown, to establish the compensatory character of such agreements, so that here in particular, approximate "indemnity" roughly speaking, is involved, and not "gain or income" on the basis merely of investment of premiums.

In the recent case of *United Security Life Ins. & Trust Co.* v. *Brown*, 113 Atlantic, 446; 270 Pa. State, 270, the Court said:

"The question of the insurable interest of the employer in the life of the employee, or of the corporation in its officers, though not the subject of discussion in Pennsylvania, has been considered in other jurisdictions, where it is held that *there is no implied interest in the life of such person justifying the issuance of a policy for the benefit of the employer.* Victor v. Louisa Cotton Mills, 174 N. C., 107; 16 L. R. A., N. S., 1020; 16 Ann. Cases, 291 Cf. Tate v. Commercial Bldg. Ass., 97 Va., 74; 45 L. R. A., 243; 75 Am. St. Rep., 770. *To sustain a contract of this character, it must further appear that there is a real concern in the life of the party named, whose death would be the cause of substantial loss to those who are named as beneficiaries. This does not follow the cessation of ordinary service, but arises where the success of the business is dependent on the continued life of the employee. In such case the insurance contract will be upheld.* Mutual Life Ins. Co. of N. Y. v. Board Armstrong & Co., 115 Va. 836; L. R. A., 1915, F. 979; Keckley v. Coshocton G. Co., 86 Ohio St., 213; Ann. Cases, 1913, D. 607; Mechanics Natl. Bank v. Comms., 72 N. H., 12; 101 Am. St. Rep., 650."

In Burlingham v. Crouse, 228 U. S., 459, the Court, in holding that a bankrupt assured has the right to retain life insurance policies, subject only to the duty, where the policy has a surrender value, to pay the surrender value over to the Trustee in Bankruptcy, recognized the anomalous character of life insurance as property, even under the Bankruptcy Law, and said:

"While life insurance is property, it is peculiar property. Legislatures of some of the States have provided that policies of insurance shall be exempt from liability for debt, and in many States provision is made for the protection from such liability of policies in favor of those dependent upon the insured. (See Holden *v.* Stratton, 198 U. S., 202.)"

(g) Much light is thrown upon the question whether such life insurance policy proceeds are "income" or not, in the recent address of Prof. C. C. Plehn as president of the American Economic Association entitled—

> "*The Concept of Income, as Recurrent Consumable Receipts.*" (American Economic Review, March, 1924),

which deals particularly with "income" under "Income Tax Laws", and from which the following passages are excerpted:

> "*One of the essential characteristics of income is anticipated recurrence* * * * Income is essentially wealth available for recurrent consumption, *recurrently* (*or periodically*) *received.* Its three essential characteristics are: *receipt, recurrence, and expendability.* It is wealth looked at primarily from the point of view of time. Income is distinguished from capital, in that capital is thought of as *possessed;* not as being received; capital is regarded as *continuing* or enduring, *not as recurring;* as wearing out, but not as recurrently consumed or used to live on; and as something to be maintained in as enduring a form as possible * * * *That recurrence, more often expressed as regularity, is an essential feature of income, has been pointed out by many writers.* But most of them express it by saying that income is a "flow of wealth" a metaphor which involves serious logical difficulties, and overstresses the idea of regularity or continuity. As I use it here, recurrence does not necessarily imply regularity nor, of course, irregularity, but merely *periodicity* * * * By the term spendable, it may be well to explain, is meant that they may be used to live on without direct impairment of one's anticipated or expected future income. That is, spending may not interfere with recurrence * * * *Treasure trove, a gift of capital, an inheritance are all*

likewise spendable receipts. That is, they may be spent without impairment of anticipated future income from sources available before they are received. But of course it is not considered wise to spend these, unless they are small, but to treat them as continuing or as capital, using only the income therefrom for spending."

In line with this is the language of *Prof. Edwin R. A. Seligman* in an article in the American Economic Review, Vol. IX, No. 3, on "*Are Stock Dividends, Income?*", which was submitted by Judge Hughes and Mr. Geo. W. Murray as counsel for defendant in error in Eisner v. Macomber, 252 U. S., 189, but was in part criticized by Prof. Plehn in the passage just quoted. In it, he wrote:

"The second characteristic of *income* is that it denotes a *flow or succession, of such satisfactions expressed in money or money's worth, during a period of time.* If there is only a single utility or a unique service we speak of an *accession*, rather than of a *succession* of satisfactions. *But whether there be one or many, we think of their coming in during a period of time. The quality of periodicity is essential.* Thus income must be either annual, or monthly or daily income, or *income for some other period of time.* Income is spoken of as a result of the capital. In capital, value is a result of the income or income value * * * Income represents a flow or stream of utilities or money, and capital represents a fund or stock of utilities or money. *The flow or stream* is *periodic;* it represents a succession of utilities or money during a period of time. The fund or stock is the accumalation of such utilities or income at an instant

of time. Income is expressed in terms of a flow; capital in terms of a stock * * * The income is primary, the capital is secondary."

In several of the cases in this Court, quoted hereinbefore, the chief elements of "income" expounded by these distinguished economists, were emphasized, including, of course, the factor of the derivation of income "from capital, from labor or from both," and its contrast to "capital," and to some extent, the matter of *expected recurrent periodicity.* As the ordinary understanding as to the meaning of the term in 1913 is the test, the other factor emphasized by Prof. Plehn, as to probably intended "expendability" is also of importance, for proceeds of life insurance policies are not ordinarily regarded as spendable income, but, on the contrary, are analogous to gifts, bequests and treasure trove. As to *the element of "recurrent periodicity,"* which Prof. Plehn emphasizes, it is, of course, fatal to the theory that life insurance proceeds are "income," and the holding that "a gain from sale or conversion of capital assets" is income, even from isolated transactions, not in the line of one's particular business, is not inconsistent with this view (*Merchants' L. & T. Co.* v. *Smietanka,* 255 U. S., 509 at 520). Recurrent periodical gain is sought in such a case, too, unlike the case of a life-insurance policy payable at death. Moreover, it is only by eliminating the factor of the human life involved, on which the whole policy turns, that one can even plausibly argue that the insurance money is the proceeds of the aggregate premiums, regarded as capital. The factor emphasized by this Court in Doyle v. Mitchell Bros. Co. *supra,* which also impressed Attorney General Gregory materially, the duty to restore "capital value,"—including the human life, as well as prem-

iums paid—must be met, before the proceeds of the policy, less dividends, can be regarded as "income." The argument as to the necessity of the element of recurrent periodicity in income, is moreover, further emphasized by other authorities under our Income Tax Laws. In

U. S. v. *Oregon Washington R. & Nav. Co.*, 251 F. R., 211 (C. C. A.)

Judge Learned Hand, writing, said in rejecting the theory that a six million dollar gift to a corporation by its sole stockholder, by way of release to it of an obligation, was taxable income:

> "However, the tax, though it includes income *'from all sources,'* nevertheless includes 'income' only, and *the meaning of that word is not to be found in its bare etymological derivation. Its meaning is rather to be gathered from the implicit assumptions of its use in common speech. The implied distinction, it seems to us, is between permanent sources of wealth and more or less periodic earnings.* Of course, the term is not limited to earnings from economic capital, *i. e.*, wealth industrially employed in permanent form. It includes the earnings from a calling, as well as interest, royalties, or dividends, though in the case of corporations this may be of slight importance. *Yet the word unquestionably imports, at least so it seems to us, the current distinction between what is commonly treated as the increase or increment from the exercise of some economically productive power of one sort or another, and the power itself, and it should not include such wealth as is honestly appropriated to what would customarily be regarded as the capital of the corporation taxed.* Now, it seems to us hardly arguable that the cancellation of the debt in question was not in the category of capital. The corporation had just commenced its busi-

ness; the cancellation of the debt was a means of contribution to its capital account, quite as though the money had been contributed by the stockholder only to enhance the value of his stock. The financial relief, so given, will, it is true, be eventually reflected in the income, since the defendant will no longer be entitled under the act to deduct the interest on the debt; but that only brings out more clearly *its character as capital contribution.* We regard the difference as precisely equivalent to the difference between the cancellation of a portion of the mortgage bonds and a cancellation of an equal proportion of their coupons. Common usage would, if we are right, unfailingly allocate the first as an increase in capital assets and the second as an increase in income. That, as we view it, is the proper test of the act."

In *Gavit* v. *Irwin*, 275 F. R., 643,

Judge Cooper held a bequest of income for life until the testator's daughter became of age, not taxable income under the Income Tax Law of 1913, but capital bequeathed to such beneficiary.

The Court said:

"If this is income, therefore, it is the income, not of the capital of the plaintiff, but of the capital of a portion of the Brady estate, which capital will never be that of the plaintiff. * * * This ('income arising or accruing from all sources') must, however, be held to mean moneys, which are essentially income, and which are income received from the labor or capital or both * * * of the person sought to be taxed, and to be limited by the provisions of subdivision B."

This decision was very recently affirmed by the U. S. Circuit Court of Appeals (Dec. 10, 1923; Federal Income Tax Service, 1923, pp. 869-877, not yet officially reported), in an opinion in which the Court pointed out that the provision of the Act of

1913 quoted above, making legacies and bequests non-taxable as income, unlike the income therefrom, is an

> *"exception, rather than an exemption,"*

language directly applicable to the section here involved also, and in itself meeting the Government's claim below herein, that "exemptions" are to be strictly construed, even apart from the claim that no "income" is involved at all. The Court concluded that, under the language of the Act of 1923,

> "what he (plaintiff beneficiary of income) receives, continues to be a legacy or bequest, and he is still a legatee."

> In *U. S.* v. *Merriam*, 282 F. R., 851 (affirmed by this Court in 263 U. S., 179),

the Circuit Court of Appeals said, as to the legacy given to an executor in lieu of commissions:

> "Everything that comes in is not income, taxable under the statute. * * * A legacy acquired by bequest does not proceed from labor."

(h) As an Income Tax is clearly here involved, even as regards the corporation sections, it is immaterial to consider whether Congress could have passed an excise tax, taxing corporations so heavily on the proceeds of insurance policies, regardless of the constitutional mandate applicable to direct taxes, and under a statute avowedly taxing income only, of both individuals and corporations.

POINT II.

The Revenue Law of 1918 does not authorize the taxation of the proceeds of life insurance policies payable to a corporation beneficiary, as "income."

(a) Nearly all of the arguments made under the prior point are applicable here also, as no "income" is involved, as that term is employed in the Act, and we have a long-established national policy against taxing life insurance policies as "income."

(b) *It is, however, stretching language unreasonably, to construe the provisions involved as authorizing such taxation as income in the case of corporation beneficiaries.* What was done was, simply, to insert an affirmative provision in Section 213, the provision of the Act dealing with individual incomes, exempting from such taxation

> "the proceeds of life insurance policies paid upon the death of the insured to individual beneficiaries or to the estate of the insured."

The express adoption of this section—covering all income embraced by the whole "Part I"—in Section 233, in the next Part, dealing with corporate income, cannot reasonably be construed as making such policies, when payable to corporations, taxable as income. If it had been intended to make such corporate receipts thus taxable—even assuming that they could have been made taxable as income—Congress would have expressly included such policies, just as modifications of the earlier "income" clauses are expressly set forth in the very next clauses of Section 233. *To transform an express adoption clause into an exception is, we submit, unreasonable, for the very purpose of an adopting clause is to establish the same rule for*

each class, in the absence of unmistakable language to the contrary (36 Cyc., 1152; *U. S.* v. *Cella,* 37 App. D. C., 423; *White* v. *Fuller,* 226 Mass., 145; *Farmers Bank* v. *Hale,* 59 N. Y., 53). Such overliteralness has been repeatedly condemned by the Courts.

> *U. S.* v. *Dominici,* 78 Fed. Rep., 334, 337 C. C. A.;
> See also *Holy Trinity Church V. U. S.,* 143 U. S., 457, 459-462.

As said by this Court at page 461 in the last-cited case, in quoting from an earlier decision of its own:

> "*All laws should receive a sensible construction. General terms should be so limited in their application as not to lead to injustice, oppression or an absurd consequence.* It will always, therefore, be presumed that the legislature intended exceptions to its language which would avoid results of this character. *The reason of the law in such cases should prevail over its letter. The common sense of man approves the judgment mentioned by Puffendorf, that the Bolognian law which enacted 'that whoever drew blood in the streets should be punished with the utmost severity,' did not extend to the surgeon who opened the vein of a person that fell down in the street in a fit.* The same common sense accepts the ruling, cited by Plowden, that the statute of 1st Edward II, which enacts that a prisoner who breaks prison shall be guilty of felony, does not extend to a prisoner who breaks out when the prison is on fire, 'for he is not to be hanged because he would not stay to be burnt.' And we think that a like common sense will sanction the ruling we make, that the act of Congress which punishes the obstruction or retarding of the passage of the mail, or of its carrier, does not apply to a case

of temporary detention of the mail caused by the arrest of the carrier upon an indictment for murder."

It was well said on this point by the lower Court herein:

> "*It would be more logical to imply that as the act declared the proceeds of policies of life insurance was not income in the case of individuals, the same definition of income applied in the case of corporations, and as the act had defined what income was in one case, it was not necessary to define it in the other.* Especially is this true when it is remembered that the definition of 'gross income' is the same in both cases, and in construing the act with reference to the proceeds of insurance policies, whether individual or corporate, it would not be a strained construction to say that *as the definition of 'gross income' is the same in both cases, the item of proceeds of insurance policies excluded in the one case is also excluded in the other*—that *it is not in fact an exemption, but a definition of what is and what is not income within the meaning of the act*, and to clinch the matter the revenue act of 1921 makes no distinction between individual and corporation life insurance policies."

(c) The same result follows from the application of the elementary principle, that

> "*In the interpretation of statutes levying taxes, it is the established rule not to extend their provisions by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the Government, and in favor of the citizen.* * * * We are unable to assert that alimony paid to a divorced wife under a decree of court falls fairly within any of the terms employed."

The language just quoted, used by this Court, speaking by Mr. Justice McReynolds, in

Gould v. *Gould*, 245 U. S., 151,

holding that alimony is not subject to an income tax, was applied in the case of

U. S. v. *Coulby*, 251 F. R., 982, 985 (affirmed 258 F. R., 27),

as prevailing, as against the rule that exemptions from taxing acts should be strictly construed, which doctrine the Government involves herein also. See also *U. S.* v. *Field*, 255 U. S., 257, 262, 264.

(d) *The fact that Congress, in the present Revenue Act of 1921, omitted this alleged discrimination against corporate beneficiaries, after the question had been raised by the Commissioner's ruling, on the one hand, and the Attorney General's opinion as to exemption of accident insurance, on the other, is a legislative declaration that such insurance, payable to corporations, is not taxable income, and that the old established general policy against taxability was intended to be continued.*

U. S. v. *Coulby*, *supra* (at 985-6);
Bailey v. *Clark*, 21 Wall., 284;
Johnson v. *Southern Pacific Co.*, 196 U. S., 121;
Wetmore v. *Markoe*, 196 U. S., 68, 76-7;
U. S. v. *Field*, 255 U. S., 257, 264-5;
U. S. v. *Bhagat Sing Thind*, 261 U. S., 204, 215.

(e) *The decisions under the Income Tax Laws in*

Gould v. *Gould*, 245 U. S., 151 (Alimony) and

U. S. v. *Merriam*, 263 U. S., 179 (Legacy in lieu of Executor's Commissions)

indicate the unwillingness of this Court to strain at taxability of alleged income in doubtful cases such as this, all three involving "peculiar" kinds of property.

(f) ***Moreover, life insurance proceeds are taxable under the Estate Tax provisions (subject to an exemption up to $40,000 where payable to third party beneficiaries), and this Revenue Act of 1918 also levied an excise tax on the taking out of all insurance policies at the rate of eight cents per $100 of insurance.*** (*Bankers & Mutual Ins. Ass.* v. *Walker*, 279 F. R., 53 C. C. A.) *The law discountenances the double or even multiple taxation that would result from taxing the same fund over again as income* (*Crocker* v. *Malley*, 219 U. S., 223, 233). In fact, it is interesting to observe that in the debate on the 1913 act in the Senate, one of the Senators in charge of the bill pointed out that a reason for excepting devises and bequests from the Income Tax provision was that they were to be reached by an Inheritance tax (Congressional Record, Vol. 50, p. 3839), and this same argument applies as to life insurance policies, when the latter were subsequently made taxable. Moreover, a discriminatory and inequitable result would be reached in taxing such life insurance policies, when the payees are corporations, and not taxing them in the cases of individual beneficiaries, especially when the former are cases where the payee pays the premiums, while the latter commonly involve gratuities. Serious questions as to the constitutionality of such a discriminatory course arise (*Gulf, Coronado & S. R. Co.* v. *Ellis*, 165 U. S., 150; *Brushaber* v. *Union Pacific R. Co.*, 240 U. S., 1, 24-5).

(g) Particularly relevant on several of the questions here involved, is the decision of the Court in

Tyler v. Treasurer, 226 Mass., 306,

in which the Court declined to treat life insurance policies payable to third party beneficiaries as taxable, despite general language covering them. Said the Court:

> Rugg, C. J.—"The question raised in these cases is whether money paid to the beneficiary under a policy of life insurance is subject to the succession tax. The policies here in issue all are well recognized forms of genuine life insurance. Manifestly money so paid does not pass 'by will, or by the laws regulating intestate succession.' But it is contended in behalf of the Treasurer and Receiver General that it is comprehended within these words of St. 1912, c. 678, Sec. 1, as amended by St. 1913, c. 498: '*All property* within the jurisdiction of the Commonwealth, corporeal or incorporeal, and any interest therein, belonging to inhabitants of the Commonwealth, * * * *which shall pass * * * by deed, grant or gift*, except in cases of a *bona fide* purchase for full consideration in money or money's worth, *made or intended to take effect in possession or enjoyment after the death of the grantor, * * * shall be subject to a tax*.' Confessedly the beneficiary of each of the insurance policies in the cases at bar receives nothing by way of 'deed' or 'grant.' Hence the only word of the statute which can be argued to be operative is 'gift.' A policy of life insurance is a contract. It is commonly a tripartite agreement, to which the parties are the insured, the insurer and the beneficiary. A policy of life insurance is a contract for a consideration paid, usually in money, in one sum or at different times during the continuance of the risk, which involves the payment of money or other thing of value by the insurer to the

family, kindred, representative, or other designated beneficiary of the holder of the policy, conditioned upon the continuance or cessation of human life, or which involves a guaranty, assurance or pledge of an endowment or an annuity. * * *

"The contract of life insurance differs from most other contracts, in that it is not intended ordinarily for the benefit of the insured, but of some dependent. Its original and fundamental conception is a provision by small, periodical contributions to secure a benefit for the family. While this conception has been enlarged in some respects, and especially in its commercial aspects, still the basic elements continue and are found in all the cases at bar. The insured retains no ownership of that which has passed to the beneficiary under the contract. A reserved right to change the beneficiary does not affect the essential nature of the rights of the beneficiary so long as they last. Whatever the insured does in way of designation of a beneficiary takes effect forthwith. *If his act rightly be describable as a gift, it is a present gift which, so far as concerns him, takes effect at once both in possession and enjoyment by the beneficiary.* * * *

"The insured has not title to the amount due on the policy. He does not and cannot make a gift of that. The right to that amount as an instant obligation does not spring into existence until after his death. Even then the money belongs to the insurer, who is charged with the duty by the contract to pay to the beneficiary. *So far as the insured is a 'grantor,' to use the word of the statute, the only thing which he grants or can grant is an interest in a contract. So far as he can make a 'gift,' the only thing which he has to give is a right in a contract.* By designating a beneficiary, both the 'grant' and the 'gift,' so far as either exist at all, take effect in enjoyment and possession at once. *Such a relation does not by fair intendment come within the descrip-*

*tive words of the statute as 'property * * * which shall pass * * * by * * * gift * * * made or intended to take effect in possession or enjoyment after the death of the grantor.'*

*"Tax laws are not to be stretched beyond their reasonable meaning, but rather in cases of doubt are to be construed with some strictness. * * * If an alleged right to tax does not fall within the words of the governing statute, it does not exist. * * ** None of the policies in the cases at bar are commercial contracts which bear any *earmarks of being designed to avoid the operation of the tax law.* On the contrary, *they are well recognized forms of insurance which have been in common use for a long time. The conclusion is that sums received by beneficiaries in accordance with designations made in contracts of insurance are not subject to the succession tax. This conclusion is confirmed by the practical construction put upon the law by those charged with the enforcement of the law through many years, a circumstance sometimes entitled to considerable weight.* Burrage *v.* County of Bristol, 210 Mass., 299. *It is in harmony with the few other decisions which have come to our attention where this point is involved.* (Estate of Bullen, 143 Wis., 512, 523; Matter of Parsons, 117 App. Div. [N. Y.], 321; Vogel's Estate, 1 Penn. Co. Ct., 352.)"

Since then, *Matter of Voorhees,* 200 App. Div., 259, is similar; but, as seen, the Federal Estate Tax Act levies an inheritance tax on such policies in excess of $40,000, in line with *Matter of Allis,* 174 Wis., 527, as the language was unmistakable.

In the lower Court, the characteristics of such life insurance policies as are here involved, upon the life of a dominating corporate official and payable to the corporation, were well expressed as follows, with respect to the theory that "income" within the Federal Income Tax is also involved:

"It cannot be said that the proceeds of life insurance policies come within the meaning of the above definition. It seems to us, that *in this case the contract of insurance was a contract to indemnify the plaintiff for the loss which it would incur by reason of the death of its president.* The plaintiff company *did not invest money with any expectation that it would receive a return from it. On the contrary, the money which it expended in paying the premiums on the policies might very well never have been returned to it:* the probabilities were that the money would not have been returned, because the person insured had a much greater expectation of life than five years, the term of the policy. *The money so paid out cannot be considered an investment from which the company could expect an income.*"

(h) The very serious question also presents itself, on the Government's assumption, as to when a life insuance policy becomes payable to a corporate "beneficiary," and whether taxability is supposed to be limited to the case of policies originally made so payable, or embraces the case of policies originally payable to individual beneficiaries, and assigned some time before maturity to corporations. In the former case, it would be a simple matter to take the policy out in the first instance in the name of an individual, and assign it to a corporation, and only the unwary would be mulcted by this heavy tax. In the other contingency, however, a most serious consequence to thousands of individuals and corporations would result from an unintended result of this tax law. The Court will doubtless take judicial notice of the fact that many millions of dollars are loaned to beneficiaries of life insurance policies on the security of assignments of their policies, that often policies expressly provide for loans

up to the surrender value, and at specified interest rates, to be made either by the insurance company or its subsidiaries, and that often third party lenders, commonly corporate, will pay further sums for an absolute assignment of the policy, after its surrender value is reached, and it can no longer be carried. Are all such lenders to be mulcted, and *ex post facto,* at that, by the amount of the tax? Are they to be thus unjustly taxed, even after the amount of the loan had been fixed, at the inception of the policy, at sums having no relation to such unanticipated heavy assessment? Moreover, individual beneficiaries are also deeply concerned, both as policy-holders interested in the corporation and, in addition, if such future sums cannot be secured upon their policies, except in as far as there may be a prior subsisting obligation to loan up to a certain sum on the part of certain companies. Such argument indicates the grave "injustice and unreasonableness" that would result from the Government's theory.

POINT III.

The judgment appealed from should be affirmed.

Respectfully submitted,

HENRY NECARSULMER,
MAX J. KOHLER,
Of Counsel,
as *Amici Curiae.*

March 31, 1924.

SUPREME COURT OF THE UNITED STATES.

No. 447.—October Term, 1923.

The United States, Appellant, *vs.* The Supplee-Biddle Hardware Company.	Appeal from the Court of Claims.

[May 26, 1924.]

Mr. Chief Justice Taft delivered the opinion of the Court.

The Supplee-Biddle Hardware Company sued the United States in the Court of Claims to recover $55,153.89, with interest, as taxes illegally assessed on the proceeds of two life insurance policies paid to it as the beneficiary on the death in 1918 of the insured, Robert Biddle, 2nd. Biddle was elected President of the Company in February, 1917. He was then thirty-seven years of age, in good health, and had for nearly twenty years held various offices in the Biddle Hardware Company, which had merged with the appellee company in January, 1914. He was a man of ability, energy and initiative and was so regarded in the hardware trade. The returns from the Company's business under Biddle's management had been much increased. At the instance of the Board of Directors and the expense of the Company, he took out the two policies for $50,000 each. They were term policies for five years. The Company intended thus to make secure its financial position, and to indemnify itself against losses to its earning power in the event of Biddle's death.

The Revenue Act of 1918, which was passed February 24, 1919 (40 Stat. 1057, ch. 18), in prescribing the income to be taxed, deals first with individuals, from Section 212 to Section 228, inclusive. Then follows provision for the rate of income tax on corporations, beginning with Section 230. Section 233(a) says "That in the case of a corporation subject to the tax imposed by section 230 the term 'gross income' means the gross income as defined in Section 213", with certain exceptions not here material. Section 213 defines the gross income for individuals as follows:

"That for the purposes of this title (except as otherwise provided in Section 233), the term 'gross income'—

"(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service . . . of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits, and income derived from any source whatever . . . ; but

"(b) Does not include the following items, which shall be exempt from taxation under this title:

"(1) The proceeds of life insurance policies paid upon the death of the insured to individual beneficiaries or to the estate of the insured."

The Treasury Department, construing these sections, held that the proceeds of insurance policies paid to a beneficiary which was a corporation, were not exempted and were included as "gains . . . from any source whatever." Under this ruling the appellee was forced to pay a tax of $84,737.95 on the proceeds of the two policies of $97,947.28. The Commissioner of Internal Revenue reduced this amount by $29,584.06 in accordance with the powers conferred upon him by Sections 327 and 328 of the Revenue Act of 1918 to reduce the rate of taxation in cases of unusual hardship. There remained, however, the sum of $55,153.89, which tax the appellees paid under protest, and for this with interest, the Court of Claims gave judgment to the appellee.

We think the Treasury Department erred in assuming that Congress intended by Sections 233 and 213 to distinguish between individual beneficiaries and corporate beneficiaries in including the proceeds of life insurance policies as within gross income. We think the two sections have no such purpose. Section 213 primarily applies only to the taxing of individuals. The union of proceeds of life insurance payable to individual beneficiaries and to the estate of the assured was thus intended to emphasize the exclusion from taxation in the hands of individuals of all such proceeds and to leave no doubt of it. The meaning is the same as if the clause had read "the proceeds of life insurance shall not be included in gross income whether they are paid to individual beneficiaries or to the estate of the assured." When Congress came to deal with the gross income of corporations, it made use of Section 213 by refer-

ence and grafted it on to 233. It is reasonable that the purpose of Section 213 to exclude entirely the proceeds of life insurance policies from taxation in the case of individuals should be given the same effect in adapting its application to corporations, and that such proceeds should be so excluded whether by the direction of the insured they were to go to specially named beneficiaries or were to inure to the estate of the insured.

Nor do we find any difficulty with the expression in paragraph (b) which *exempts* proceeds of life insurance from gross income. The word is used not to indicate that they would be otherwise included in the income to be taxed, but only to make clear that the gross does not include them.

It is earnestly pressed upon us that proceeds of life insurance paid on the death of the insured are in fact capital and can not be taxed as income under the Sixteenth Amendment. *Eisner* v. *Macomber*, 252 U. S. 189, 207; *Merchants Loan and Trust Company* v. *Smietanka*, 255 U. S. 509, 518. We are not required to meet this question. It is enough to sustain our construction of the Act to say that proceeds of a life insurance policy paid on the death of the insured are not usually classed as income.

Life insurance in such a case as the one before us is valid and is not a wagering contract. There was certainly an insurable interest on the part of the Company in the life of Biddle. *Mutual Life Insurance Company of New York* v. *Board*, 115 Va. 836; *Keckley* v. *Coshocton G. Co.*, 86 Ohio State; *Mechanics National Bank* v. *Commins*, 72 N. H. 12; *United Security Life and Trust Company* v. *Brown*, 270 Penn. State, 264. Life insurance in such a case is like that of fire and marine insurance, a contract of indemnity. *Central Bank of Washington* v. *Hume*, 128 U. S. 195. The benefit to be gained by death has no periodicity. It is a substitution of money value for something permanently lost either in a house, a ship, or a life. Assuming without deciding that Congress could call the proceeds of such indemnity, income, and validly tax it as such, we think that in view of the popular conception of the life insurance as resulting in a single addition of a total sum to the resources of the beneficiary, and not in a periodical return, such a purpose on its part should be express, as it certainly is not here.

This view is strengthened by the fact that under Section 402, p. 1097, of the same revenue law of 1918, a decedent's estate tax is

levied, with rates ranging from one per centum to twenty-five per centum on the net estate which is made to include (par. f) "the amount receivable by the executor as insurance under policies taken out by the decedent upon his own life; and to the extent of the excess over $40,000 of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life." The result of the construction put by the Government upon Sections 233, 230 and 213 would be to impose a double tax on the proceeds of the two policies in this case over and above $40,000, i. e., an income tax and an estate tax. Such a duplication even in an exigent war tax measure is to be avoided unless required by express words.

The judgment of the Court of Claims is affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.